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**APPENDICES**

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## CHAPTER 1: INTRODUCTION

### SECTION 1: INTRODUCTION TO THE ASSET MANAGEMENT HANDBOOK

#### 1.1 ABOUT THIS HANDBOOK

This handbook provides Multi-Family Housing staff with guidance about the Agency's procedures for overseeing borrowers' performance in meeting their responsibilities under the program. Its goal is to help Loan Servicers in Field Offices provide consistent, effective oversight of projects financed by the Agency to ensure that they are operated in accordance with applicable regulatory and administrative requirements. This role is defined as asset management.

This handbook presents the Agency's asset management procedures for:

- Section 515 Multi-Family Housing projects:
  - ◊ Rural rental housing (including congregate housing and group homes); and
  - ◊ Rural cooperative housing.
- Section 514/516 Farm Labor Housing projects:
  - ◊ Off-farm labor housing; and
  - ◊ On-farm labor housing.

The guidance provided by this handbook is intended to be consistent with all applicable laws, Executive Orders, and Departmental regulations, including other Agency regulations. Nothing contained in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

#### 1.2 COMPANION MULTI-FAMILY HOUSING HANDBOOKS

This handbook is the second in a series of three handbooks that describe the requirements and procedures for the Multi-Family Housing direct loan and grant programs. The two companion handbooks are:

- **HB-1-3560: Loan Origination.** This handbook covers the requirements and procedures for processing loan and grant applications for Multi-Family Housing projects, selecting projects for Agency funding, and closing the loans and grants for these projects.
- **HB-3-3560: Project Servicing.** This handbook addresses the requirements and procedures for servicing loan accounts, allowable servicing actions borrowers can request, project preservation, prepayment, and Agency actions in the event of compliance violations or project default.

## 1.3 USING THIS HANDBOOK

The handbook is organized to allow the reader to look up information on specific topics easily. Several graphic tools and conventions have been used to make information easier to find and understand.

### A. Citations and Text Boxes

- **Regulatory citations.** The regulation for Multi-Family Housing programs is provided in 7 CFR Part 3560. The text of that regulation is included in **Appendix 1**. To help readers locate the regulatory authority for procedures described here, references to this regulation in paragraph headings appear in italicized brackets, for example: *[7 CFR 3560.51]*. Other regulations or RD Instructions are simply referenced.
- **Form references.** Agency forms and Agency guide, form, and system letters are shown in *italics*. All forms referenced in this handbook can be found in **Appendix 3** and all letters can be found in **Appendix 4**.
- **Examples and exhibits.** Text boxes labeled as examples provide a specific illustration of a concept described in the text. Exhibits illustrate key points and are numbered in sequence, using the chapter number and a sequence number; for example, Exhibit 3-1 is the first exhibit in Chapter 3.

### B. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence using the chapter number and a sequence letter; for example, **Attachment 4-A** is the first attachment in Chapter 4.
- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters.

### C. Terminology

Because terminology may vary from state to state and may change over time, this handbook uses certain standard terminology to provide consistency.

- **Agency.** The term “Agency” is used throughout this handbook to refer to the Rural Housing Service (RHS) within the U.S. Department of Agriculture (USDA) that is responsible for the administration of the Multi-Family Housing programs.
- **Approval Official.** This term is used whenever someone other than the Loan Servicer must approve an action.

- **Borrower.** The term “borrower” refers to one or more individuals who are receiving Agency assistance through a Multi-Family Housing program in the form of a loan or a grant.
- **Field Office.** Because the number of offices and the nature of the work conducted in each office may vary from state to state, the term “Field Office” is used throughout this handbook to refer to the office that is originating or servicing the loan.
- **Loan Servicers.** This term refers to Agency Field Office staff with responsibility for ensuring that multi-family housing borrowers comply with program requirements and for servicing loan accounts.
- **Management Agent.** A “management agent” is an entity that contracts with the borrower to perform the management functions necessary to effectively operate a multi-family housing project.
- **State Director.** This term is used to refer to the Director of the State Office or the Agency staff person to whom the State Director has delegated decision-making authority for a specific aspect of the program. Unless otherwise specified, each State Director may determine which actions may be approved at the Field Office and which must be approved at the State Office.

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## SECTION 2: OVERVIEW OF THE AGENCY'S MULTI-FAMILY HOUSING PROGRAMS

### 1.4 GOALS OF THE RHS MULTI-FAMILY HOUSING PROGRAMS

The purpose of the Multi-Family Housing programs is to provide adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. In providing this service, the Agency strives to meet several goals.

- **Customer service.** The Agency is committed to providing customer-friendly, streamlined service. The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders.
- **Partnerships.** The Agency's ability to serve eligible households is enhanced by working with its partners, such as borrowers, property management agents, tenants, other lenders, nonprofit organizations, and state and local agencies.
- **Effective use of resources.** As publicly funded initiatives, the Agency's Multi-Family Housing programs must use tax dollars efficiently. The Agency aims to minimize administrative costs, underwrite loans responsibly, and leverage funding with private sources of credit to the extent possible.

### 1.5 SECTION 515 PROGRAM—OVERVIEW

The Section 515 direct loan program [*7 CFR Part 3560*] provides financing to support the development of rental units in rural areas that need housing affordable for very low-, low-, and moderate-income households, and where this housing is unlikely to be provided through other means.

Section 515 loans can be used to build, acquire and rehabilitate, or improve dwellings in rural areas. The term for loans is tied to the expected useful life of the property, and the standard term for an initial Section 515 loan is 30 years with a 50-year amortization period. However, the term for subsequent loans and loans for special types of properties, such as manufactured housing, may be made for a shorter term based on the project's expected useful life.

Each loan is made at a note rate established by the Agency as prescribed in RD Instruction 440.1. Borrowers approved for initial and/or subsequent loans receive interest credit that reduces the effective interest rate for the Agency's financing, thereby lowering the property's rents. In return for this below-market rate financing, the borrower agrees to lease the project's rental units to income-eligible households at rents approved by the Agency.

## **1.6 SECTION 514/516 PROGRAMS—OVERVIEW**

Section 514/516 direct loan and grant programs provide funds to support the development of adequate, affordable housing for farmworkers that is unlikely to be provided through other means.

### **A. Section 514 Loans and Section 516 Grants for Off-Farm Housing**

Section 514 loans and Section 516 grants can be used for the same purposes as Section 515 loans to finance rental housing for farmworkers. Unlike Section 515 projects, Off-Farm Labor Housing projects may be built outside rural areas, as long as the project addresses a need for affordable housing for farmworkers. These projects are eligible for financing at terms comparable to Section 515 loans, a grant to cover a significant share of the development cost, or a loan/grant combination finance package. Tenants not only must be income-eligible, but also receive priority based on the proportion of their income received from farm work.

### **B. Section 514 Loans for On-Farm Housing**

Section 514 loans can also be used to finance the development of adequate housing for farmworkers involved in a specific farm operation—On-Farm Labor Housing projects. These projects are treated as part of the farming operation, and the occupants may or may not pay rent.

Labor housing borrowers who are providing shelter for domestic farm housing that is restricted for use by eligible residents supporting the borrower's farming operation may choose to provide that housing to residents without imposing charges for rent or utilities or may choose to impose charges for rent, utilities, or rent and utilities subject to Agency approval. All other Labor Housing borrowers who are providing shelter in support of farming operations in the community at large are expected to operate the program in accordance with Agency regulations governing the approval of charges for rent, utilities, or rent and utilities subject to Agency approval.



## SECTION 3: GENERAL PROGRAM REQUIREMENTS

### 1.7 CIVIL RIGHTS [7 CFR 3560.2]

The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders. The civil rights compliance requirements for the Agency are contained in RD Instruction 1901-E. Exhibit 1-1 lists the applicable Federal laws and Executive Orders and highlights key aspects of these requirements.

#### Exhibit 1-1

##### Major Civil Rights Laws Affecting the Multi-Family Housing Loan and Grant Programs

- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally-assisted program on the basis of race, color, and national origin.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally-assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally-assisted program on the basis of age.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by Executive Order 12259.** Prohibits discrimination in housing or residential property financing to any Federally-assisted activity against individuals on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally-assisted construction contracts in excess of \$10,000. Provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.
- **Executive Order 12898.** Requires each federal agency to make achieving environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

## A. Nondiscrimination

The various civil rights laws prohibit the denial of loans, grants, services, and benefits provided under the Section 515 and 514/516 programs to any person on the basis of race, color, national origin, sex, religion, marital status, familial status, age, physical or mental disability or source of income, or because the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act (15 U.S.C. 1601). Discrimination in employment practices is also prohibited. These same requirements also apply to program participants. Agency oversight of borrower compliance with civil rights laws is covered further in Chapters 3, 6, and 9. Civil rights complaints filed by tenants are handled by the Agency in accordance with RD Instruction 2000-GGG.

Effective management and consistent procedures are good business practices that help ensure that all applicants are treated fairly. Poor program implementation, whether or not discrimination is intended, has possible civil rights consequences.

## B. Reasonable Accommodations for Persons with Disabilities

In addition to avoiding discrimination, the Agency and loan and grant recipients must make reasonable accommodations to permit persons with disabilities to apply for and benefit from Agency programs. Reasonable accommodations may include providing modifications to the dwellings and facilities so that they are physically accessible. Reasonable accommodations may also include effective communication and outreach tools so that all applicants can obtain program information (e.g., a Telecommunications Device for the Deaf [TDD]).

### Key Civil Rights Issues for Asset Management

- Access
- Consistency and fairness of treatment
- Disparate impacts—intended or unintended
- Record keeping

## C. Limited English Proficiency [7 CFR 3560.2]

Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from Federally-assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

## D. Civil Rights Impact Analysis

Agency employees will conduct civil rights impact analyses in accordance with RD Instruction 2006-P, to determine whether proposed policy actions, if approved and implemented, will negatively and disproportionately affect employees, program

beneficiaries, or applicants for employment or program benefits due to race, national origin, or other protected basis.

## **1.8 REVIEWS AND APPEALS [7 CFR 3560.9]**

Decisions that are not made in favor of a program participant (applicant or borrower) are known as adverse decisions. Adverse decisions must be based upon regulations that are published in the Code of Federal Regulations (CFR). For the direct Multi-Family Housing programs, any adverse decisions must be based upon 7 CFR Part 3560 and not the administrative guidance contained in this handbook. Adverse decisions include: (1) administrative actions taken by Agency officials; and (2) the Agency's failure to take required actions within time frames specified in statutes or regulations, or within a reasonable time if no deadline is specified.

**Appendix 2** contains 7 CFR Part 11, which is the regulation of the National Appeals Division (NAD) and provides procedures that both Agency officials and program participants must follow when an appeal is made. *Handbook Letter 101 (3560), Standardized Adverse Decision Letter*, will be used for all adverse decisions unless another format is prescribed in this handbook.

### **A. Informing Program Participants of Their Rights**

Whenever an Agency official makes a decision that will adversely affect a program participant, the official must inform the participant in writing that an informal review with the person who made the decision may be requested. If the decision is appealable, the participant will also be informed of their rights to seek mediation or Alternative Dispute Resolution (ADR) and to request a hearing with NAD; **Attachment 1-B** is used for this purpose. If the decision cannot be appealed, participants will be informed of their rights to have NAD review the accuracy of the Agency's finding that the decision cannot be appealed; **Attachment 1-C** is used for this purpose. Mediation or ADR rights are not provided on decisions that cannot be appealed.

Letters notifying participants of adverse decisions must contain the required information regarding an informal meeting, mediation or ADR, rights to NAD, and civil rights. RD Instruction 2000-GGG includes only the specific civil rights language that must be contained in any adverse decision letter. **Attachments 1-B** through **1-I** contain, as necessary, the civil rights language and include information on requesting an informal review, mediation or ADR, and rights to a NAD appeal. The attachments are all titled to assist Field Staff in selecting the correct Attachment for the decision being made. The Attachments do not need to be used when an RD Form, Handbook Letter, or other document already includes the appropriate participant rights.

## **B. Adverse Decisions That Cannot Be Appealed**

Certain decisions made by the Agency cannot be appealed. In these cases, the participant is still provided the opportunity for an informal review, however, appeal rights to an NAD and rights to mediation or ADR are not offered. Participants will be informed through the use of **Attachment 1-C** that they may request an informal review and write to NAD for a review of the accuracy of the Agency's determination that the case cannot be appealed. Decisions that cannot be appealed include:

- Decisions made by parties outside the Agency, even when these decisions are used as a basis for Agency decisions (such as when an applicant disagrees with a private lender's decision not to provide credit for a leveraged loan);
- Denials of credit due to lack of funds; and
- Rural area designations.

When one or more of the reasons for an adverse decision are reasons that cannot be appealed, the adverse decision cannot be appealed. In these cases, the letter containing the adverse decision will include only the items that cannot be appealed as the reason why the decision cannot be appealed. If other reasons also exist for the adverse decision, they will be listed separately in the decision letter as other reasons the assistance could not be granted.

## **C. Informal Review**

Participants who want to request an informal review with the person who made the decision must do so within 15 days of the date of the Agency's letter notifying the participant of the adverse decision. The participant must make a request for an informal review in writing, and the request will be retained in the participant's case file. The informal review can be conducted, at the discretion of the Agency by telephone or through a face-to-face meeting. The informal review can also be conducted by a representative of the person who made the decision. The purpose of the informal review is to further explain the Agency's reasons for the adverse decision, listen to why the participant feels the decision may be incorrect, and obtain any further information from the participant to support their request. The review must be completed within 45 days of the request, and the participant is notified in writing of the results. The State Director

may require that the decision be reviewed by the next-level supervisor or other designated Rural Development staff before the participant is notified of the decision. **Attachment 1-D** will be used if the adverse decision is not reversed as a result of the informal review. If the decision is reversed, a letter will be sent to the participant notifying them of the decision and next steps.

Participants may skip an informal review and, if applicable, request mediation, ADR, or a NAD appeal. In doing so, participants automatically waive their rights to an informal review.

#### **D. Mediation or ADR**

Adverse decisions that are appealable to NAD also require that the participant be given the opportunity to seek mediation or ADR prior to having a hearing with NAD. The purpose of mediation or ADR is to resolve disputes through the use of a neutral mediator. State Directors may wish to consider issuing a State Supplement, outlining the coordination required between the Field Office and State Office on handling mediation and ADR requests.

Participants may skip mediation or ADR and request a NAD appeal. In doing so, they automatically waive their rights to mediation or ADR.

##### ***1. Requests for Mediation or ADR***

After receiving **Attachment 1-B** or **1-D**, a program participant may request mediation or ADR services. Upon receipt of the program participant's request for mediation or ADR, **Attachment 1-E, 1-G, or 1-H** is sent to the participant to start the process. The Attachment used depends upon whether the state in which the action applies is covered by a USDA-sponsored mediation program. These Attachments are generally sent by the State Director since costs are involved; however, they can be sent directly by the Field Office at the discretion of the State Director.

##### ***2. Cost of Mediation or ADR***

There are generally costs associated with participation in mediation or ADR. When there are costs, they will be shared equally between the Agency and the program participant, if Agency funds are available. Where Agency funds are not available, the Agency will participate in mediation or ADR if requested by the program participant; however, the program participant will be notified in advance of the portion of the cost that the Agency will pay (if any) and their estimated cost for this service. The State Director will ensure that all participants requesting mediation or ADR in their state are treated consistently and pay the same percentage of the cost toward this service. The State Director may also consent to pay a larger percentage (up to 100 percent) of the cost of mediation or ADR for participants with incomes below the poverty level. The Agency will notify the mediation or ADR sources of how the cost of such service will be paid. **Attachments 1-E, 1-F, 1-G, and 1-H** include language to meet this requirement.

### ***3. Mediation in States with a USDA-Sponsored Mediation Program***

Many states have a USDA-sponsored mediation program. These programs are funded, in part, by USDA and were established primarily to mediate cases originating from the Farm Service Agency (FSA). If program participants are unsure if a USDA mediation program exists in their state, they should contact their State Director. In states with a USDA-sponsored mediation program, program participants who are provided appeal rights generally will be referred to the USDA-sponsored mediation program. ADR is not applicable in these states. **Attachment 1-E** may be sent to the program participant to acknowledge their request, and **Attachment 1-F** may be used to refer the case to the USDA-sponsored mediation program. In states where alternative mediation sources are readily available at a lower cost than the USDA-sponsored mediation program, the state will follow the guidance for states without a USDA-sponsored mediation program, and include the USDA sponsored mediation program on the list of acceptable providers.

### ***4. Mediation or ADR in States without a USDA-Sponsored Mediation Program***

In states without a USDA-sponsored mediation program, Agency officials are responsible for maintaining a list of mediators or ADR providers. The State Office will generally maintain this list as program participants are referred to the State Director to initiate mediation or ADR. FSA can generally provide a list of acceptable mediation or ADR sources in a state. Other contacts include the American Association of Arbitrators (AAA) or State bar association. When making contacts with these sources, the Agency must request the services of a mediator and not an arbitrator. (A mediator resolves disputes by negotiating a resolution through mutual agreement; an arbitrator resolves disputes through hearing both parties and then rendering a binding decision and should not be used.) The list of mediators will contain the approximate cost of each service provider, if known. States may handle the list of mediation and ADR sources as follows:

- The state may select a mediator or ADR provider from the list, provided there is not a significant variation in the cost of service providers. The list will be maintained alphabetically and sources selected in sequential order. **Attachment 1-G** may be sent to the program participant to acknowledge their request for mediation or ADR, and **Attachment 1-F** may be used to refer the case to the provider. States will need to maintain documentation to ensure that mediators and ADR providers receive an equal number of referrals. If there is a significant variation in cost among service providers, this option will not be used.
- The state may provide the list of mediators or ADR providers to the participant and request the participant to select the source or provide the name of another acceptable source of mediation or ADR. The list will contain the approximate cost of each service provider, if known. **Attachment 1-H** is used for this purpose and provides the participant with 10 days to select a service provider. After selection, **Attachment 1-F** will be used to refer the case to the mediator or ADR provider. If the program participant does not provide the name of a mediator or ADR provider within 10 days, their request for mediation or ADR will be considered withdrawn. Withdrawal or

cancellation of mediation or ADR does not extinguish the participant's right to an appeal with NAD.

### ***5. Timing of mediation or ADR***

Mediation or ADR must be completed within 45 days after the case is referred to the mediation or ADR source, unless the complexity of the case warrants a longer time frame and all parties agree to a specific time frame. A mediator or ADR provider will generally conduct a teleconference between the parties prior to accepting a case to determine if the case can be mediated. The Agency encourages the use of a pre-mediation conference since many adverse decisions in the Multi-Family Housing program may not lend themselves to mediation. Regardless, the Agency will not refuse to participate in mediation or ADR if requested to do so by the program participant.

Mediation or ADR occurs prior to having a hearing with NAD. Requests for mediation or ADR made prior to filing an appeal with NAD stop the clock on the 30-day period during which a participant may appeal to NAD. After mediation or ADR has concluded, any days that remain from the 30-day period are available to the participant to request an appeal to NAD. **Attachment 1-I** is used for this purpose. The person completing **Attachment 1-I** will need to determine the number of days the participant took to request mediation or ADR. Hearing dates for participants who request mediation or ADR after filing an appeal must be selected with 45 days of the conclusion of mediation or ADR. Participants may also request mediation or ADR after filing an appeal with NAD but prior to the hearing.

### **E. Appeal**

Participants who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be signed by the participant and include: (1) a copy of the adverse decision to be appealed; and (2) a brief statement describing why the participant believes the decision is wrong.

Upon receiving a notice from NAD that an appeal has been filed, the Field Office will promptly provide NAD with a copy of the Agency record, specific references in 7 CFR Part 3560 to support the adverse decision, and any other pertinent information. A copy will also be provided to the program participant.

In accordance with NAD regulations, the program participant has the right to a face-to-face hearing in the participant's state of residence. The program participant also has the right to request that the hearing be handled by teleconference. An adverse decision made by the Agency may result in an appeal hearing and require a face-to-face hearing. In these cases, the Appeal Coordinator may request the State Director to provide Field Staff to attend the hearing and represent the Agency. The Appeals Coordinator will provide sufficient documentation and phone resources to the person selected by the State Director to adequately represent the Agency in the case.

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action

that would have occurred had no adverse decision been made must be taken within 30 days after the effective date of the notice from NAD; unless the Agency requests a review of the case by the Director of NAD. See **Appendix 2** for more guidance on Director Reviews and other information regarding appeals.

## **F. Tenants and the Tenant Grievance Process**

The Agency has a formal process for resolving tenant grievances. Tenants and applicants for tenancy may file complaints and may be entitled to a hearing, depending on whether the grievance is legitimate and whether it can be resolved through informal means. Tenant grievance procedures are discussed in detail in Chapter 6, Section 8 of this handbook.

## **1.9 CONFLICT OF INTEREST [7 CFR 3560.10]**

All Agency employees must strive to maintain the highest levels of honesty, integrity, and impartiality in conducting their activities on behalf of the Agency. The Agency's conflict of interest requirements are described in RD Instruction 1900-D. To reduce the potential for conflicts of interest, all processing, approval, servicing, or review activity must be conducted by Agency employees who:

- Are not the recipient (applicant or borrower), a recipient's family member, or a close known relative of the recipient;
- Do not have an immediate working relationship with the recipient, the Agency employee related to the recipient, or the Agency employee who would normally conduct the activity; and
- Do not have a business or close personal association with the recipient.

### **A. Applicant Disclosure**

Applicants must disclose any known relationship or association with Agency employees when they apply.

### **B. Agency Employee Disclosure**

Agency employees must disclose any known relationship or association with a recipient, regardless of whether the relationship is known to others. Loan Servicers should notify a supervisor after the application is accepted but before any eligibility determination is made.



## **1.10 OTHER FEDERAL REQUIREMENTS**

### **A. Environmental Requirements [7 CFR 3560.3]**

The Agency considers environmental quality equally with economic, social, and other factors in its program development and decision making processes. Both the Loan Servicer and the Loan Approval Official are responsible for effectively integrating Agency environmental policies and procedures with loan and grant origination and servicing activities. Agency environmental policies and procedures and historic preservation requirements can be found in RD Instruction 1940-G. Agency-assisted properties must also meet the lead-based paint requirements contained in Exhibit H of RD Instruction 1924-A. Resolution of conflicts or significant differences between Agency environmental regulations and state or local environmental laws requires prior consultation with National Office Environmental Staff.

### **B. Construction Standards**

Sites and dwellings developed or rehabilitated with Section 515 or Section 514/516 funds must meet the construction standards outlined in RD Instructions 1924-A and 1924-C. Existing dwellings must be decent, safe, and sanitary and must meet all applicable state and local codes. Certain state construction codes and requirements may influence RD Instructions 1924-A and 1924-C.

### **C. Lobbying Restrictions**

RD Instruction 1940-Q prohibits applicants and recipients of Agency assistance from using appropriated funds for lobbying the Federal Government in connection with a specific award. This Instruction also requires that entities that request or receive loans or grants must disclose the expenditure of any funds, other than appropriated funds, for lobbying activities using Exhibit A-1 from RD Instruction 1940-Q.

### **D. Administrative Requirements**

Agency employees must comply with Agency and departmental administrative requirements.

#### ***1. Procurement***

Goods and services procured to support Agency activities such as appraisals, inspections, broker services, and property management services must conform with the policies and procedures of RD Instruction 2024-A.

## ***2. File Management***

Files and other Agency records must be maintained in accordance with RD Instruction 2033-A. Additional information is provided in Chapter 9.

## ***3. Handling Funds***

Project funds must be handled in accordance with RD Instruction 1902-A.

### **1.11 EXCEPTION AUTHORITY [7 CFR 3560.8]**

Exceptions to any requirement of this handbook or 7 CFR Part 3560 may be approved in individual cases by the Administrator if application of the requirement or failure to take action would adversely affect the Government's interest or conflict with the objectives and spirit of the authorizing statute. Any exception must be consistent with the authorizing statute and other applicable laws.

Requests for exceptions are submitted to the Administrator, through the Deputy Administrator, Multi-Family Housing, and may be initiated by the State Director; the Director, Multi-Family Housing Processing Division; or the Director, Multi-Family Housing Portfolio Management Division.

The exception request must provide clear and convincing evidence of the need for the exception. At a minimum the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the Government's interest;
- A discussion of proposed alternatives considered; and
- A discussion of how the adverse effects will be eliminated or minimized if the exception is granted.

Requests to the Administrator for exceptions regarding architectural and engineering, environmental, or civil rights issues will include the review and comments of the appropriate National Office Technical Staff.

## **ATTACHMENT 1-A**

### **EQUAL CREDIT OPPORTUNITY ACT (ECOA)**

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this assistance is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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## ATTACHMENT 1-B

### ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT IS APPEALABLE

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe this decision or the facts used in this case are in error, you may pursue any or all of the following three options.

#### Option 1 - Informal Review

If you have questions concerning this decision or the facts used making it and desire further explanation, you may write this office to request an informal review. ***There is no cost for an informal review.*** This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review. You may skip this step in the informal process and select one of the following two options. If you do, you will automatically waive your right to an informal review.

#### Option 2 - Mediation or ADR

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need the information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to such service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 3). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 3.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

### **Option 3 - Request an Appeal**

You may request an appeal hearing by the NAD rather than an informal review, mediation, or ADR. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

Your request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 2.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, because of race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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## **ATTACHMENT 1-C**

### **ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT CANNOT BE APPEALED**

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving.

If you have questions concerning this decision or the facts used in making it and desire further explanation, you may write this office to request an informal review. This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review.

Applicants and borrowers generally have a right to appeal adverse decisions, but decisions based on certain reasons cannot be appealed. We have determined that reasons for the decision cannot be appealed under our regulations. You may, however, write the Assistant Director with the NAD for a review of the accuracy of our finding that the decision cannot be appealed. Your request must be made no later than 30 days from the date you receive the attached letter.

NAD Assistant Director address:

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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## ATTACHMENT 1 - D

### ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF UNFAVORABLE DECISION REACHED AS A RESULT OF AN INFORMAL REVIEW

We appreciated the opportunity to review the facts relative to your request for assistance. We regret that the decision in the attached letter did not grant the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe that facts used in this case are in error, you may pursue any or all of the following two options.

#### Option 1 - Mediation or ADR

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to this service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 2). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 2.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the National Appeals Division (NAD); however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

## **Option 2 - Request an Appeal**

You may request an appeal hearing by the NAD rather than an informal review or mediation. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

The request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 1.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing, you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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## **ATTACHMENT 1-E**

### **ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION IN STATES WITH A USDA-SPONSORED MEDIATION PROGRAM**

This replies to your request for mediation or alternative dispute resolution services. The state in which you requested assistance has an impartial USDA-sponsored mediation program available. Your request for mediation has been sent to:

You will be contacted directly by the USDA-sponsored mediation program to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for mediation services. The cost estimated for this service is:

\$ \_\_\_\_\_ You will be advised directly by the USDA-sponsored mediation program of the full cost of mediation. This is only an estimate and may vary depending on the issues and complexity of the case. If you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored program to cancel your request

Rural Development will:

\_\_\_\_\_ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.

\_\_\_\_\_ Cannot contribute towards the cost as the Agency does not have financial resources for these services. You must pay the full cost of mediation from your own personal resources.

\_\_\_\_\_ Contribute \_\_\_\_\_ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation is concluded, you will be notified of the results and the number of days remaining to request an appeal, if applicable. If you request mediation prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation does not take the

place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation.

Remember, if you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored mediation program to cancel your request. You will be responsible for any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.



## **ATTACHMENT 1-F**

### **ATTACHMENT FOR REQUESTING MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) SERVICES**

TO:

FROM:

SUBJECT: Request for Mediation or ADR Services

CUSTOMER:

The above-subject Rural Development customer has received an adverse decision from our Agency and has requested mediation or ADR services. Attached is a copy of the adverse decision letter and the customer's request for your service.

#### ***Informal Review:***

\_\_\_ The customer was provided with the opportunity for an informal review with the Agency; however, chose not to exercise this option.

\_\_\_ An informal review was conducted; however, the Agency did not reverse its decision.

\_\_\_ This case is under the jurisdiction of our State Office.

#### ***Payment for Service:***

\_\_\_ The customer and Agency will split the cost of this service 50/50.

\_\_\_ The customer will pay the full cost of mediation or ADR.

\_\_\_ The Agency will pay \_\_\_\_\_ towards mediation or ADR. The customer will pay the balance.

If the Agency is paying for any portion of the cost of this service, the bill for the Agency's portion should be submitted to this office. The customer is solely responsible for their portion of the cost of this service and should be bill directly.

***Jurisdiction of case:***

\_\_\_ The adverse decision in this case was made by the following office. You should contact this office for further information on the case:

\_\_\_ The adverse decision in this case was made by the \_\_\_[insert appropriate name]\_\_\_. You may contact the Appeals Coordinator for further information on the case and to arrange for mediation or ADR:

USDA, Rural Development

Appeals Coordinator

ATTN: \_\_\_\_\_

\_\_\_\_\_, \_\_\_\_\_

(\_\_\_) \_\_\_-\_\_\_, extension \_\_\_\_\_

Mediation or ADR must be completed within 45 days; unless the complexity of the case requires a longer time frame and all parties agree to a specific time frame. We also request a teleconference prior to your acceptance of this case to determine if the adverse decision lends itself to mediation or ADR.

## **ATTACHMENT 1-G**

### **ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF SERVICE PROVIDER**

This replies to your request for mediation or alternative dispute resolution services. Your request has been sent to:

You will be contacted directly by the above to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

\$ \_\_\_\_\_ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

\_\_\_\_\_ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.

\_\_\_\_\_ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.

\_\_\_\_\_ Contribute \_\_\_\_\_ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office and the mediation or ADR provider to cancel your request. You will be responsible for

any costs incurred by the mediation or ADR source up until the time of your cancellation.  
Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

## ATTACHMENT 1-H

### ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF POTENTIAL SERVICE PROVIDERS

This replies to your request for mediation or ADR services. Attached you will find a list of mediation and ADR providers. You will need to select one of the sources from the list, or you may provide the name of another independent mediation or ADR source. You must provide this office, in writing, with the name of the provider within 10 days. Rural Development will then contact the source and provide photocopies of the adverse decision letter and any other relevant information. We will also request that the mediation or ADR provider conduct a teleconference between the parties.

If we do not receive your selection of a mediator or ADR provider within 10 days, we will consider such inaction to be your notice to cancel your request for mediation or ADR. You may continue to pursue an appeal to the NAD as outlined in our original adverse decision letter.

As indicated in our original adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

\$ \_\_\_\_\_ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

\_\_\_\_\_ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.

\_\_\_\_\_ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.

\_\_\_\_\_ Contribute \_\_\_\_\_ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office to cancel your request. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

## ATTACHMENT 1-I

### ATTACHMENT FOR NOTIFYING CUSTOMERS THAT MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) DID NOT RESULT IN RESOLUTION OF ISSUES

We regret that we are unable to grant the assistance you requested or will terminate or reduce the assistance you requested. Mediation or ADR did not result in resolution of the issues.

If you believe the decision or facts used in the case are in error, you may pursue your right to an appeal by the NAD. ***There is no cost for an appeal.*** The number of days in which you have to request an appeal depends upon whether you previously requested an appeal to NAD prior to entering into mediation or ADR. ***Please follow the guidance in the paragraph indicated with an "X".***

\_\_\_ You requested an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address to schedule the appeal hearing:

NAD Assistant Director address:

\_\_\_ You did not request an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address. Your request must be postmarked within \_\_\_ days from receipt of this letter. This represents the difference between 30 days and the number of days you took after the adverse decision to request mediation or ADR. Use the NAD Assistant Director address is listed above.

#### Information regarding appeals

You have the right to an appeal hearing within 45 days of NAD's receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide, and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

cc: NAD Assistant Director



## **CHAPTER 2: MULTI-FAMILY HOUSING PROGRAMS AND ASSET MANAGEMENT**

### **2.1 INTRODUCTION**

This chapter introduces key aspects of the Section 515 Multi-Family Housing and Section 514/516 Farm Labor Housing programs. Under these programs, the Agency provides direct loans and grants to support the development of affordable rental housing that serves rural areas. The Section 538 Multi-Family Housing Guarantee program—the Agency’s third Multi-Family Housing Program that guarantees loans made by private lenders—is covered in a separate regulation, [7 *CFR Part 3565*] and handbook (HB-1-3565).

This chapter also presents the asset management framework that the Agency uses to oversee borrower performance in meeting their responsibilities under the program. The framework provides Loan Servicers with a consistent basis for ensuring that borrowers’ operation of projects meets the objectives of the program and complies with applicable program requirements.

Section 1 introduces the types of loans and other forms of assistance available through the Section 515 program and the Agency’s objectives in providing this assistance. Section 2 describes the loans, grants, and other assistance available to increase the supply of affordable housing specifically targeted toward farm labor. The chapter concludes with Section 3, which outlines the Agency’s asset management framework, as well as the key parties involved.

### **SECTION 1: SECTION 515 PROGRAM**

### **2.2 OVERVIEW**

The Section 515 program offers direct loans to eligible borrowers to provide economically designed and constructed housing and related facilities for very low-, low-, and moderate-income households; elderly households; and persons with disabilities living in rural areas. This section of the chapter describes:

- The types of projects allowed;
- The types of loans available;
- Rental assistance available from the Agency; and
- The Agency’s preference for leveraged projects.

### **2.3 TYPES OF PROJECTS**

There are six types of rental projects that can be developed using Section 515 loans:

- Family projects;

- Elderly projects;
- Congregate projects;
- Group homes;
- Rural cooperative housing; and
- Mixed projects.

The housing must be economical and must not include elaborate features, but must be adequate to meet tenants' needs. The project should be of average quality and cost. With the exception of off-farm labor housing, all projects must be developed in locations that qualify as rural areas.

### **A. Family Projects**

A family housing project is a rental property developed for occupancy by eligible very low-, low-, and moderate-income households. Nonelderly and elderly households may occupy the housing. Household income is the only tenant characteristic, except under extraordinary circumstances such as tenant displacement, which is given preference in selecting among eligible applicants for occupancy. Priority is also given to those needing features of an accessible unit if one becomes available. Occupancy may not be restricted to particular groups of eligible households and may include elderly households.

### **B. Elderly Projects**

An elderly project is a rental property that is developed for occupancy solely by eligible elderly households, which include a tenant or cotenant who is disabled or age 62 years or older. Very low-, low-, or moderate-income households that do not qualify as elderly households are not eligible to live in these projects unless they consist of surviving nonelderly members of a household in which the elderly tenant is deceased.

### **C. Congregate Projects**

Congregate projects are rental properties developed for occupancy by eligible very low-, low-, or moderate-income elderly households that need meals or other services to assist them in performing activities of daily living. Congregate projects consist of private apartments and central dining facilities in which a number of allowable preestablished services are provided to tenants. These projects are not designed to be nursing homes and, therefore, are not allowed to pay for the cost of medical- or healthcare-related services. When leasing units, priority may be given to eligible elderly households who qualify for the services provided by the facility.

## **D. Group Homes**

A group home is housing that is occupied by eligible very low-, low-, and moderate-income elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

## **E. Rural Cooperative Housing**

Section 515 loans may be used to finance rural cooperative housing projects operated by nonprofit consumer cooperatives for the benefit of eligible very low-, low-, and moderate-income members.

## **F. Mixed Projects**

Mixed projects are properties developed with a portion of the units designated as family units and the remainder of the units established as elderly units. At the time the project is developed, the borrower must designate the units that will be operated as family units and those that will be operated as elderly units.

## **2.4 TYPES OF LOANS**

The rules governing the origination of Section 515 loans differ slightly, depending upon the type of loan being made. The types of loans available under Section 515 include:

- Initial loans;
- Subsequent loans; and
- Assumed loans.

Loans are only made to projects that further the program's objectives and comply with applicable Agency requirements.

### **A. Initial Loans**

Initial loans are made to projects with no existing Agency loan. Most initial loans are made to build new properties. However, the Agency does make initial loans for rehabilitation of existing properties when it is in the Agency's best interest.

The interest rate for these loans is set at the note rate established in RD Instruction 440.1. The Agency then provides interest credit assistance, which reduces the effective interest rate to 1 percent<sup>1</sup>. Interest credit is only provided for units occupied by eligible tenants paying at least 30 percent of their income for rent. The administration of interest credit is covered in Chapter 7 and also in HB-3-3560.

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<sup>1</sup> Some existing projects do not receive interest credit, while others receive interest credit that reduces the interest rate to three percent. However, all initial loans made by the Agency following the publication of this handbook will receive interest credit as described here.

The Agency establishes the term of these loans to correspond to the expected useful life of the property. The maximum term is 30 years with a 50-year amortization period. Generally, initial loans are made for a term of 50 years, with the exception of properties where the expected useful life is a shorter period (e.g., manufactured housing).

## **B. Subsequent Loans**

Subsequent loans can be issued during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property or in conjunction with the transfer of a property where the purchaser is assuming the initial Agency loan. The key differences between processing requirements for subsequent and initial Section 515 loans are discussed in Chapter 11 of HB-1-3560. Guidance regarding the requirements and procedures for processing project transfers is covered in the HB-3-3560. Subsequent loans may also be used to finance equity to avert prepayment of the project.

## **C. Assumed Loans**

Section 515 loans may be assumed in conjunction with the transfer of ownership of the property. The terms and conditions of the assumption depend upon the needs of the project at the time of the transfer.

### ***1. New Rates and Terms Assumption***

Most assumptions of Section 515 loans are new rates and terms assumptions—that is, the purchaser assumes responsibility for all or a portion of the remaining debt. To conserve the Agency's budgetary resources, the transaction does not involve paying off the old loan and issuing a new initial loan. Instead, the purchaser assumes the outstanding debt, which is reamortized at new rates and terms. New rates and terms assumptions are used when the purchaser will experience financial difficulties under the terms of the initial loan or when a change in rates and terms is necessary to facilitate the transfer. Purchasers may apply for subsequent loans to make up the difference between the amount of debt assumed and the purchase price or to address physical needs at the project.

### ***2. Same Rates and Terms Assumption***

Transfers may also take place in conjunction with a same rates and terms assumption. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

## **2.5 RENTAL ASSISTANCE**

Owners of projects located in areas where prospective tenants are likely to be overburdened by rent or where existing tenants are already overburdened can apply for rental assistance administered by the Agency. This rental subsidy assists tenants by allowing them to pay 30 percent of adjusted income for rent, thereby reducing the financial burden on the household. The Agency pays the difference between the tenant contribution and the approved shelter costs for the unit through the rental assistance contract with the borrower.

## **2.6 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS**

To maximize the number of units produced with Section 515 loan funds, the Agency gives preference to project applications for new loans that leverage other funds, thereby reducing the amount of Section 515 loan funds needed to develop the project. The greater the leveraging proposed in a project application, the greater the preference for funding. Examples of funds that count as leveraged funds include borrower resources beyond the minimum required amount, equity generated by the sale of low-income housing tax credits (LIHTCs), a second loan from another lender, or a grant from a state or local public agency or other source.

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## **SECTION 2: SECTION 514/516 PROGRAM**

### **2.7 TYPES OF PROJECTS**

The Section 514/516 Farm Labor Housing program provides funds to support the development of housing for farm labor. Section 514/516 assistance differs from the Section 515 loans in the following ways:

- The objective of the program is to provide housing for farmworkers;
- There are no rural restrictions; and
- Agency grants are available to support the development of these projects.

Section 514/516 assistance may be used for Off-Farm Labor Housing projects and Section 514 assistance may be used only for On-Farm Labor Housing projects. Section 514 assistance may be used in conjunction with Federal LIHTCs.

#### **A. Off-Farm Labor Housing**

The Agency is authorized to make loans and grants for financing off-farm labor housing to broad-based nonprofit organizations; nonprofit organizations of farmworkers; Federally recognized Indian tribes, agencies, or political subdivisions of state or local government; and public agencies (such as local housing authorities). Section 514 loans can be made to limited partnerships in which the general partner is a nonprofit entity.

#### **B. On-Farm Labor Housing**

On-farm labor housing is designed to provide adequate housing for farmworkers involved in a specific farming operation. Individual farmers, family farm corporations or partnerships, or associations of farmers may develop these projects but must operate them on a nonprofit basis. To qualify for occupancy, an individual or a household must simply be employed as part of the farming operation. There is no income restriction governing occupancy. However, immediate family members of individuals with an ownership interest in the farm are prohibited from living in this housing in the property.

### **2.8 LOANS AND GRANTS**

#### **A. Farm Labor Housing Loans**

Section 514 loans for Farm Labor Housing projects are very similar to Section 515 loans. However, they differ in two important ways:

- These loans carry a 1 percent effective interest rate (i.e., there is no interest credit); and
- The maximum term for these loans is 33 years.

These loans can be used to finance either Off-Farm or On-Farm Labor Housing projects.

At one time, loans for both types of projects were processed on a first-come, first-served basis. Today, lending decisions regarding loans for Off-Farm Labor Housing projects are handled through a competitive NOFA process, while loans for On-Farm Labor Housing projects are still processed in the order that they are received. Chapter 12 of HB-1-3560 provides more detailed information about the origination process for Farm Labor Housing loans.

## **B. Farm Labor Housing Grants**

Section 516 grants may only be used to support the development of Off-Farm Labor Housing projects. These grants may be used for the same purposes as Section 514 loans when there is reasonable doubt that the housing would not be provided without the grant. Chapter 12 of HB-1-3560 provides more information about the origination process for these grants.

## **2.9 RENTAL ASSISTANCE**

Applicants for Section 514/516 assistance for Off-Farm Labor Housing projects may also apply for rental assistance administered by the Agency. The requirements for obtaining rental assistance are the same as for Section 515 projects. Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under Section 514 or Section 516 that serve migrant farmworkers. On-Farm Labor Housing projects are not eligible for this rental assistance.

## **2.10 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS**

Like the Section 515 program, the Agency gives preference to applications for Off-Farm Labor Housing projects that leverage other sources of funds. There is no leveraging preference for On-Farm Labor Housing applications.



## SECTION 3: ASSET MANAGEMENT FRAMEWORK

### 2.11 ASSET MANAGEMENT

The goal of the Agency's asset management procedures is to ensure that projects receiving Agency financing operate in a manner consistent with the program's objectives and comply with applicable requirements. Accordingly, this handbook covers the following aspects of project operation and oversight:

- Project Management;
- Financial Management;
- Physical Condition of the Project;
- Project Occupancy;
- Project Rents; and
- Rental Subsidies.

It presents the program requirements in each of these areas and describes the Agency's procedures for monitoring properties to ensure that borrowers, their agents, and tenants are fulfilling their responsibilities.

In addressing each topic area, the handbook first presents the requirements and procedures for Section 515 rental projects and then discusses differences or additional requirements for other types of projects (e.g., congregate housing, Farm Labor housing, cooperatives).

### 2.12 KEY ASSET MANAGEMENT ACTIVITIES AND DOCUMENTS

#### A. Key Agency Activities

The Agency uses the same basic procedures to oversee the performance of all types of multi-family housing projects that it directly finances. While the Agency's oversight activities are essentially the same for all types of projects, the aspects of borrower performance examined during these activities will vary by type of project due to differences in requirements.

#### Asset Management

Asset management refers to Agency oversight of project performance to ensure that operation of the property furthers the program's objectives and complies with applicable Agency requirements.

Agency oversight activities fall into three major categories:

- Oversight of new projects or borrowers;

- Annual oversight activities; and
- Periodic oversight activities.

The specific activities in each category are summarized in Exhibit 2-1.

<b>Exhibit 2-1</b> <b>Key Asset Management Activities</b>	
<b><u>Agency Actions for New Projects:</u></b>	<ul style="list-style-type: none"> <li>• Conduct pre-occupancy meeting;</li> <li>• Conduct post occupancy review;</li> <li>• Review project worksheets; and</li> <li>• Review of quarterly/monthly reports.</li> </ul>
<b><u>Annual Agency Actions:</u></b>	<ul style="list-style-type: none"> <li>• Review project worksheets;</li> <li>• Review of project annual financial report;</li> <li>• Annual review of project reserve account (new);</li> <li>• Annual physical review;</li> <li>• Review and approval of project budget for the coming year;</li> <li>• Respond to evidence of potential compliance concerns (e.g., substantiated tenant complaints, reports by other Agency staff or offices, information provided by public or other agency); and</li> <li>• Respond to servicing requests from borrowers.</li> </ul>
<b><u>Periodic Agency Actions:</u></b>	<ul style="list-style-type: none"> <li>• Perform physical inspection of project;</li> <li>• Perform occupancy review of project;</li> <li>• Perform management review of project; and</li> <li>• Conduct compliance reviews.</li> </ul>
All of the above require follow-up to address deficiencies.	

## B. Key Documents

Borrowers' responsibilities under the program and evidence that they are complying with program requirements are established through program loan and grant documents. The key program documents used in Agency asset management activities are listed in Exhibit 2-2.

**Exhibit 2-2****Key Program Documents**

- Mortgage or deed of trust;
- *Form RD 3560-52, Promissory Note*;
- Loan agreement/resolution;
- Grant agreement;
- Interest credit and rental assistance agreement;
- Rental assistance agreement;
- Management plan;
- Management certification;
- Management agreement;
- Affirmative Fair Housing Marketing Plan;
- Project worksheet;
- Utility allowance documentation;
- Tenant certification;
- Dwelling lease;
- Project budget;
- Annual financial report for project; and
- Agency Monitoring Forms.

## **2.13 ASSET MANAGEMENT PROCEDURES FOR MULTI-FAMILY HOUSING PROJECTS**

Chapters 3 through 9 describe the program requirements for Section 515 projects.

### **A. Property Management (Chapter 3)**

Borrowers must comply with a number of program requirements regarding general project management functions. The borrower's plans for project management are documented in management documents (the management plan and management entity profile). The Agency must also approve the project's management agent and review management fees for reasonableness.

### **B. Financial Management (Chapter 4)**

Borrowers must establish project financial management systems and procedures that reflect the complexity of project operations and provide adequate supervision to ensure that program objectives are met. The Agency has specific requirements regarding project accounting, budgeting, financial reporting, and project annual financial reports. The borrower's accounting system identified in the management plan must comply with the Agency's chart of accounts. The Agency will monitor project accounts through project reports and monitoring visits to the site. The Agency approves the budget on an annual basis and reviews financial reports on an ongoing basis.

**C. Project Physical Conditions (Chapter 5)**

Borrowers are responsible for maintaining their projects' physical conditions to meet program standards for decent, safe, and sanitary housing. Loan Servicers will monitor the quality of the housing through regular physical inspections of the property as well as through the budget process. The Agency will review the borrower's capital budget planning and approve reserve withdrawals for capital improvements. In the event that a borrower fails to meet program standards, Loan Servicers are responsible for ensuring that the borrower takes appropriate actions to correct physical deficiencies.

**D. Project Occupancy (Chapter 6)**

Loan Servicers will monitor borrowers' compliance with program occupancy rules, ensuring that tenant eligibility requirements are observed and occupancy policies are consistently followed. The borrower must market the project to all eligible applicants and process applications, select tenants, and assign units in a fair and consistent manner. Borrower must also observe Agency rules regarding dwelling leases, tenant recertification, termination of occupancy, and tenant grievance procedures. Loan Servicers will check compliance with these requirements through regular reports and monitoring visits to the site.

**E. Rents, Shelter Cost, and Utility Allowances (Chapter 7)**

Loan Servicers will review projects to ensure that the borrower establishes appropriate rents, occupancy charges, and utility allowances for individual units and, on an annual basis, review budgets to approve or deny requests for rent changes. Loan Servicers will also ensure that the borrower meets all requirements in handling the following:

- Tenant rent payments during evictions;
- Tenant security deposits; and
- Cases of tenant fraud.

**F. Rental Subsidies (Chapter 8)**

A multi-family housing project may have one or more types of rental subsidy including Agency rental assistance (RA), HUD Section 8, or other local forms of rental subsidy. Loan Servicers must ensure that borrowers comply with requirements to use RA appropriately. Only eligible projects, units, and tenants may receive rental subsidies. The borrower must enter into a rental subsidy agreement with the appropriate agency. Agency staff have administrative responsibilities for RA including suspending or transferring RA, replacing expiring RA agreements, and processing borrower requests for additional RA, modifying RA agreements and agency oversight of borrower performance.

**G. Monitoring Borrower Compliance (Chapter 9)**

Loan Servicers must perform regular reviews of multi-family housing projects to monitor project performance and ensure compliance with program regulations and civil rights laws. Loan Servicers will make efforts to plan and prioritize monitoring activities to focus on the projects that need the most Agency attention. Borrowers will submit reports on an ongoing basis (either monthly or quarterly, as needed) to provide the Agency with much of the information needed to monitor project performance. However, Field Office Staff will also perform site visits as part of annual reviews, physical inspections, and occupancy and management reviews.

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## **CHAPTER 3: PROPERTY MANAGEMENT**

### **3.1 INTRODUCTION**

This chapter provides an overview of the essential responsibilities for property management. In general, the borrower is responsible for providing management acceptable to the Agency both in terms of staff qualifications and management practices. The borrower must ensure that property operations comply with the terms of all loan or grant documents; Agency requirements; and applicable local, state, and Federal laws and ordinances. For many project management responsibilities, the Agency must approve or concur in the management decisions and policies of the borrower. This chapter is designed to identify those actions that require Agency reaction to the borrower's decision.

Section 1 of this chapter deals specifically with property management, including Agency approval of the proposed management agent and management certification. It also describes the Agency's requirements regarding items that must be addressed in the borrower's management plan (Exhibit 3-1 and Paragraph 3.3); and civil rights and accessibility requirements, self-evaluations, and transition plans (Paragraph 3.4).

Section 2 discusses the requirements for acceptable management entities and the Agency's procedures for reviewing and approving new management entities. It also outlines the Agency's procedures for removing unacceptable management entities.

Section 3 describes the program requirements regarding allowable management fees to be paid out of project income and Agency procedures for assessing the reasonableness of the fees.

Section 4 addresses the required insurance coverage and real estate taxes for projects.

Section 5 discusses the project management requirements and procedures that differ for Farm Labor Housing projects.

### **SECTION 1: PROJECT MANAGEMENT [7 CFR 3560.102]**

### **3.2 OVERVIEW OF PROJECT MANAGEMENT RESPONSIBILITIES**

Borrowers must provide management acceptable to the Agency as a condition of loan or grant approval. The borrower requirements listed in this chapter may be complied with by the borrower or a person designated in writing by the borrower. Acceptable management will be documented in the management plan and management certification.

### **3.3 THE MANAGEMENT PLAN [7 CFR 3560.102(b)]**

For each multi-family housing project, borrowers must develop and maintain a management plan that establishes the systems and procedures that will be employed at the project to ensure that project operations comply with Agency requirements. This plan is used by the Agency to guide its oversight of project operations and its monitoring of project compliance.

The management plan should provide the Agency with information regarding site operations only, not about management agent central office functions.

A management plan is initially submitted as part of the borrower's application for funding. It remains in effect until such time as the Agency requires modification of the plan, the plan needs to be updated to reflect changes occurring in project operations, or the project is transferred from one borrower to another.

## **A. New Projects**

### ***1. Requirements for Submitting a Management Plan***

For new projects, borrowers must submit a management plan that addresses the required items identified in Exhibit 3-1 in sufficient detail to enable the Agency to effectively monitor project performance.

If the Agency determines that a proposed management plan does not adequately address the required items, Loan Processing Staff will provide written notice to the borrower indicating the deficiencies and specifying a time period for submission of an acceptable plan.

No Agency loan will be closed, construction started, or transfer approved before the Agency has an acceptable management plan from the borrower.

### ***2. Contents of a Management Plan***

At a minimum, management plans for multi-family housing projects must address the items presented in Exhibit 3-1.



**Exhibit 3-1**  
**Required Items for Project Management Plans**

- A. **Maintenance.** Describe the systems, including procedures for carrying out routine maintenance, decorating, inspections, and capital item repair and replacement, that will be employed to ensure that the project is adequately maintained.
- B. **Personnel.** Describe the job descriptions, staffing plans, and site functions to be performed by site staff or central office staff assuming frontline duties. Provide a list of staff whose salaries will be paid from the project's operating account; the list must include job titles and approximate salary, including hourly rate; a statement of each position's duties, if not obvious by title, and whether the position is full- or part-time; and if the employee will be working for more than one project and/or working part-time for the agent in a nonsupervisory capacity, a statement of how that person's time and salary will be allocated. Note: Salaries of management agent supervisory staff not assigned to the project must be paid from the management fee.
- C. **Financial operations.** Provide example of the accounting system the management agent will use (approved by the Agency) and the procedures for ensuring that the system is implemented in accordance with Agency requirements. Highlight what accounting systems will be performed onsite. Describe procedures for recordkeeping.
- D. **Procurement.** Describe the procurement procedures used at the project to ensure that the Agency procurement requirements are met.
- E. **Rents.** Describe the project's procedures for rent, occupancy charge, security deposit, and fee collection (such as late fees) and for implementing a rent, utility allowance, occupancy charge increase, or change in fees.
- F. **Overage.** Affirmative statement that borrower/management agent is responsible for overage, if borrower/management agent fails to properly recertify the tenant. The tenant is responsible for overage (note rent) when the tenant fails to recertify.
- G. **Marketing.** Describe the project's procedures for marketing units to ensure compliance with the Fair Housing laws, and *Form HUD 935.2, Affirmative Fair Housing Market Plan (AFHMP)*.
- H. **Leasing.** Describe the onsite procedures regarding unit leasing that will be employed to ensure compliance with program occupancy requirements, including applicant eligibility, maintaining and purging the waiting list, certifying and recertifying income, tenant selection, terminating leases, and evictions. Project occupancy policies, occupancy rules, dwelling lease forms, and sample waiting list forms that have received Agency concurrence should be included as attachments.
- I. **Tenant relations.** Describe project procedures for ensuring that applicant and tenant grievances are handled in accordance with program requirements and that tenants participate in property operations. Work with tenant association, if one exists, to address tenant concerns.
- J. **Supplemental services.** Describe any supplemental services offered at the project and the procedures for providing these services, including laundry, vending machines, and security.
- K. **Previous participation certification.** *Form RD 1944-37, Previous Participation Certificate* reports the names of all principals and affiliates of the management agent and any previous housing projects in which they have participated. It further certifies that they are currently eligible to participate in the management of Agency projects.
- L. **Section 504 compliance.** Describe how management will make known to tenants and applicants that reasonable accommodations under Section 504 will be made at the borrower's expense (unless such accommodations would cause an undue financial or administrative burden). Also describe how such requests are to be made, and who within management will have the authority to approve or disapprove a request for an accommodation.
- M. **Compliance with State and Local Requirements.** Make an affirmative statement that management plan complies with state and local requirements.
- N. **Allowable expenses.** Describe the allowable expenses that will be charged to the project and those that are included in the management fee.

### ***3. Agency Review of a Proposed Management Plan***

In reviewing a proposed management plan, the Agency must ensure that it does not contain policies that violate Agency regulations and that it provides adequate details regarding the items in Exhibit 3-1 for the Agency to effectively monitor project compliance with program requirements.

## **B. Existing Projects**

### ***1. General Requirements for Maintaining and Modifying a Management Plan***

In accordance with the requirements of this chapter, the borrower must develop and maintain a management plan acceptable to the Agency. A borrower's failure to maintain an acceptable plan is grounds for Agency termination of the management agent. This management plan will remain the guiding management document, as long as it accurately reflects project operations and the borrower remains in compliance with Agency rules and regulations.

Borrowers must submit an updated management plan to the Agency if project operations change and are no longer consistent with the current management plan on file with the Agency. The Agency should expect to see a modified management plan when:

- Project operations change to meet the needs of a changing tenant population;
- Program requirements change; or
- Changes in subsidy levels or types occur (e.g., HUD Section 8 is converted to Rental Assistance and/or units are reduced) or the property is converted to another allowable use (e.g., changed from a family property to an elderly property).

When a housing project is transferred from one borrower to another, the transferee must submit a new management plan that addresses the items listed in Exhibit 3-1.

### ***2. Agency Request for and Review of a Modified Management Plan***

If the Agency determines that project operations are in compliance with Agency requirements; loan or grant agreements; or applicable local, state, and Federal laws but are not consistent with the management plan, the Agency will notify the borrower of the discrepancy in writing and indicate that the existing plan is no longer acceptable. Upon receiving notice that project operations are not consistent with the current management plan, borrowers must take one of the following actions within 60 days from the date of the Agency's letter:

- Revise the management plan to accurately reflect housing operations;
- Take actions to ensure that the management plan is followed; or
- Advise the Agency in writing of the action taken.

If the borrower submits a modified management plan, the Agency will review the plan for the necessary changes and ensure that the plan adequately addresses the requirements of the discrepancy. The Agency may visit the project or management agent's office to ensure that documented changes have occurred.

### **C. Three-Year Borrower Certification of Adequacy of Plan**

When there have been no changes in a project's operations, borrowers must submit a certification to the Agency every 3 years stating that the project operations are consistent with the current management plan and that the plan is adequate to ensure project compliance with the loan documents and the applicable requirements of this part (see **Attachment 3-A**).

### **D. Projects with Compliance Violations**

#### ***1. Agency Notification to the Borrower***

If the Agency determines that there are compliance violations at a project, the borrower must respond to the Agency notification and update the management plan in accordance with the requirements below. If the borrower does not fulfill the requirements of this section, the Agency will deem the management plan for the project unacceptable, and the borrower/agent may be subject to termination of their management agreement.

#### ***2. Borrower Response to Agency Notification***

Upon receiving notice of compliance violations at a project, borrowers must address the violations in accordance with 7 CFR 3560.102(d) and update the management plan as follows:

- Borrowers must submit to the Agency, within 60 days, revisions to the management plan that establish the changes in project operation that will restore project compliance; and
- If the borrower determines that changes to the management plan are not needed because the compliance violations were due to a failure to follow the current management plan, the borrower must certify to the Agency that the management plan is adequate to ensure project compliance with the applicable requirements of this part. Borrowers must submit a written description of the actions that will be taken, including timeframes for restoring compliance with the current management plan and Agency rules and regulations.

### **E. Continued Management Discrepancies**

If the Agency discovers continued discrepancies between a project's management plan and project operations, the Agency retains the authority to terminate the current management agreement and require the borrower to install a new management entity acceptable to the Agency.

### 3.4 SELF-EVALUATIONS AND TRANSITION PLANS

On June 11, 1982, USDA issued 7 CFR 15b, which required all borrowers to conduct self-evaluations of their compliance with civil rights requirements within 1 year of the USDA regulation. Information on civil rights-related compliance issues as they affect Section 514, 515, 516, and 521 housing may be found in answers to frequently asked questions in **Attachment 3-F**. In the event that structural changes were necessary, recipients were required to develop transition plans that set forth the steps necessary to complete such changes.

Borrowers may become liable for fines and penalties imposed by enforcement agencies, loss of tax credits, or legal actions if found in noncompliance with civil rights laws. While the Agency does not impose these fines and penalties, RHS will follow regulatory, supervisory, and servicing procedures and loan eligibility requirements when noncompliance is found.

#### A. Borrowers Required to Conduct Self-Evaluations and Develop Transition Plans

The following borrowers must conduct self-evaluations and develop transition plans:

- Borrowers of projects ready for occupancy on or before June 10, 1982.
- Borrowers of projects ready for occupancy after June 10, 1982, who have been found in noncompliance with Civil Rights law (as a remedial action).
- Borrowers who have had complaints filed against them, when the Agency determines it necessary.
- Borrowers transferring ownership.
- Borrowers of projects receiving rehabilitation or equity loans, when the Agency determines it necessary.
- Borrowers receiving loans for new construction after August 20, 2002. The Agency will review the self-evaluation and any transition plan during the preoccupancy conference.
- All state and local government borrower entities. The Department of Justice issued a regulation on July 26, 1991, which requires all state and local governments to conduct self-evaluations, unless they had already done so to meet the requirements of Section 504.
- Borrowers receiving loans after January 1, 2001, if a self-evaluation has not been conducted within the last 3 years.

#### B. Standards Borrowers Must Meet

Regardless of when a project was ready for occupancy, all borrowers are required to have policies and practices that do not discriminate against persons with disabilities. Examples of such policies and practices are provided in **Attachment 3-B**. The

architectural accessibility standards borrowers must meet will depend on when the project was ready for occupancy and what modifications are planned. In addition, many state and local governments have their own accessibility standards that must be met. The Agency does not have the authority to waive any accessibility requirements.

## **C. Self-Evaluation and Transition Plan Requirements**

### ***1. Self-Evaluations***

In accordance with 7 CFR 15b, self-evaluations must:

- With the assistance of interested persons, including persons with disabilities or organizations representing disabled persons, evaluate their current policies and practices and the effects thereof;
- After consultation with interested persons, including disabled persons or organizations representing disabled persons, modify any policies and practices that do not meet the requirements of this part;
- After consultation with interested persons, including disabled persons or organizations representing disabled persons, take appropriate remedial steps to eliminate the effects of any discrimination that resulted from adherence to these policies and practices that do not meet the requirements of this part; and
- Maintain a record of the self-evaluation for at least 3 years. The record must be made available for public inspection and be provided to the Agency upon request. The self-evaluation record must contain:
  - ◊ A list of the interested persons consulted;
  - ◊ A description of areas examined and any problems identified; and
  - ◊ A description of any modifications made and any remedial steps taken.

### ***2. Transition Plans***

At a minimum, transition plans must:

- Identify physical obstacles in the borrower's facilities that limit the accessibility of their property to disabled persons;
- Describe in detail the methods that would be used to make the facilities accessible;
- Specify the schedule for taking the steps necessary to achieve full program accessibility and if the time period of the transition plan is longer than 1 year, identify steps that will be taken during each year of the transition period; and
- Identify the person responsible for implementation of the plan.

When structural changes are necessary, such changes must be made as expeditiously as possible within 3 years.

### **3.5 THE MANAGEMENT CERTIFICATION**

As a condition of Agency approval of the management agent and the management fee, the borrower and the management entity must execute a *Form RD 3560-13, Management Certification*, and submit this to the Agency each time the borrower proposes a management agent and a management agreement is executed. The borrower and the management agent must jointly submit the certification to the Agency to attest that:

- The borrower and management agent agree to operate the housing project in accordance with the management plan;
- The borrower and management entity will comply with Agency requirements and contract obligations, agree that no payments have been made to anyone in return for awarding the management contract to the management agent, and ensure that such payments will not be made in the future;
- The borrower and the management agent will comply with Agency handbooks, notices, and other policy directives that relate to the management of the housing project;
- The management agreement between the borrower and the management entity complies with the requirements described in Paragraph 3.5 A;
- The borrower and the management agent will refrain from purchasing goods and services from entities that have identity-of-interest (IOI) relationships with the borrower of the management agent until the IOI relationship has been disclosed to the Agency in accordance with Paragraph 3.6 and not denied by the Agency; and
- The borrower, management agent, and supplier of goods and services agree that all records relating to the housing project are the property of the project, the Agency, and the Agency's representatives.

The management certification also requires that the borrower and the management agent identify any and all IOI relationships that would involve project funds. *Form RD 3560-13* must be submitted to the Agency.

For management agents proposing IOI firms to provide goods and services to Agency properties, a fee schedule of these goods and services must be attached to *Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate*. The Agency must approve the borrower's use of such firms prior to the borrower entering into any contractual relationships that involve Agency funds with such entities. For a discussion of IOI relationships, see Paragraph 3.6 A.2.

After the borrower or management agent discloses an IOI relationship in *Form RD 3560-31*, the Agency may:

- Request the borrower, management entity, and supplier of goods and services to provide documentation proving that use of IOI firms is in the best interest of the housing project;
- Request that all suppliers of goods and services agree to certify in writing to the Agency that the individual or organization proposed is qualified and licensed, if appropriate;
- Request the borrower, management entity, and supplier of goods and services to agree in writing to make available all records relating to the housing project to the Agency or the Agency's representative; and
- Deny the use of an IOI firm when the Agency determines that using the firm is not in the best interest of the Federal Government or the tenants.

#### **A. The Role of the Management Agreement**

While the management certification replaces the need for the Agency to approve the management agreement, it does not eliminate the need for the borrower and the agent to execute a management agreement. By executing the management certification, the borrower and the agent are assuring Agency staff that an acceptable agreement has been executed. Agency staff may review this agreement during the triennial compliance review. At a minimum, projects with IOI agents or independent fee agents must execute a management agreement.

#### **B. Agency Approval of the Management Certification**

A certification must be submitted for Agency approval prior to the initial approval of the management agent. Subsequent certifications must be submitted for Agency approval when any of the following occurs:

- An increase in the management fee is requested;
- A new management agent is proposed; or
- A management agreement expires and a new agreement is executed or renewed.

The borrower must submit a new certification to the Agency for approval at least 45 days prior to the date of the proposed change. The Agency will return the approved or denied certification within 30 days of receipt.

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## SECTION 2: APPROVING, REMOVING, AND REVIEWING THE MANAGEMENT AGENT [7 CFR 3560.102]

### 3.6 THE MANAGEMENT AGENT

#### A. Acceptable Types of Management Entities

Exhibit 3-2 shows the three types of management entities.

**Exhibit 3-2**

**Three Types of Management Entities**

- A. Borrower/manager
- B. IOI management agent
- C. Independent fee management agent

In this Handbook, the term “management agent” applies to all three forms of management entities, unless a specific distinction is made because of policy or procedural differences.

#### *1. Borrower/Manager*

In the borrower/manager relationship, the borrower and the management agent are the same business entity. This is also referred to as “self-management.” A project is not self-managed if some or all of the same individuals are involved in both the borrowership entity and the management agent but the organizations are legally different business entities.

For example, if the borrower is a limited partnership and the general partner of the borrower entity serves as the management agent, the management agent is not a borrower/manager because the management agent and the borrower are different business entities. Instead, the management agent is an identity-of-interest management agent.

#### *2. Identity-of-Interest Management Agent*

An IOI relationship exists when an individual or entity that provides goods, management, or other services to the project has a relationship with the project borrower that is such that selection of the management agent and determination of the management fee will not be determined through an arms-length transaction. Exhibit 3-3 further describes this relationship.

Failure to disclose such IOI relationships may subject the borrower, the management agent, and other firms or employees among whom the IOI relationship exists to suspension, debarment, or other remedies available to the Agency.

**Exhibit 3-3****Identity-of-Interest Relationships**

An IOI relationship exists when:

- The borrower entity, any principal of, or a general partner of the borrower entity; or
- Any officer or director of the borrower entity; or
- Any person who directly or indirectly controls 10 percent or more of the voting rights, or owns 10 percent or more of the borrower entity

is also

- A borrower, general partner, officer, or director of the management agent company or its subcontractor; or
- A person who directly or indirectly controls 10 percent or more of the voting rights, or owns 10 percent or more of the management company or its subcontractor.

As used above, “person” refers to any individual, partnership, corporation, or other business entity. Any borrowship, control, or interest held or possessed by a person’s spouse, parent, child, grandchild, or sibling or other relation by blood or marriage is attributed to that person for this determination.

As used above, “subcontractor” refers to any individual or company that contracts with the management agent to provide management services to the project.

**3. Independent Fee Management Agent**

An independent fee management agent is a management company or individual that has no IOI relationship with the borrower and no financial interest or involvement in the project, other than earning a fee for providing management services.

**B. Approval of the Proposed Management Entity**

A management entity will be deemed acceptable by the Agency provided that the agent or staff member has a minimum of 2 years of experience and satisfactory performance in directing and overseeing the management of similar Federally assisted multi-family housing.

In addition, the Agency may issue approval to a management agent if the agent’s *Form RD 1944-37* shows that a small percentage of the properties it has managed are either in default or have a mortgage delinquency and either one of the following can be documented:

- The default or delinquency was due to circumstances beyond its control; or
- The agent is making satisfactory progress toward improving the problem property’s operations.

The Agency reserves the right to deny approval of any proposed management entity that does not meet such requirements. The Agency may issue a denial of a proposed management agent if:

- The agent and/or its staff does not have 2 years of experience successfully managing Section 514, 515, or 516 properties as relevant or other assisted housing;
- If the agent's *Form RD 1944-37*, shows that a substantial percentage of the properties it has managed are either in default or have a mortgage delinquency; or
- If the agent's *Form RD 1944-37*, shows that a small percentage of the properties it has managed are either in default or have a mortgage delinquency and the management agent is not addressing the property's or properties' deficiencies.

To request approval of the management entity, the borrower/agent must submit the following information to the project's Field Office at least 45 days before the date the borrower wishes the new agent to assume responsibility. In the case of emergency replacements of management agents, the borrower/agent must submit the information needed for the Agency to review and approve the new management agent as soon as the new agent is identified. Borrowers must submit the following documents when requesting Agency approval of an agent:

- **Management plan.** The management plan establishes the systems and procedures that will be employed onsite to ensure that project operations comply with Agency requirements (see Paragraph 3.3). *Form RD 1944-37*, (see Exhibit 3-1) must be included as an attachment to the management plan.
- **Management certification.** Using *Form RD-3560-13* (see Paragraph 3.5), the borrower and management agent together certify that they will comply with Agency requirements and contract obligations and will execute an acceptable management agent agreement, and that no payments have been made to the borrower in return for awarding the management contract to the agent nor will such payments be made in the future.
- **Additional information required by the Field Office.** Agency staff may require borrowers to submit additional information to clarify materials already submitted. Materials requested may address:
  - ◇ Determining the management agent's acceptability;
  - ◇ Monitoring the agent's compliance with Agency requirements;
  - ◇ Resolving project operating problems; and
  - ◇ Justification of contractual relationship with IOI or third-party contractors.

The Agency must review all items listed above within 30 days of receipt. The review will consist of the following:

- **Review of Previous Participation Certification.** If the management agent is new to the Agency and manages properties assisted by HUD, local public housing agencies, and State housing finance agencies, the servicing jurisdiction must obtain references from the appropriate jurisdiction on the management agent's past performance. For instance, if the management agent has managed HUD properties, then the Agency is required to contact the appropriate HUD Field Office and obtain a reference or request that HUD provide a copy of the most recent *Form RD 1944-37*.
- **Review of the proposed management plan.** This review ensures compliance with the Agency's submission requirements and determines if the proposed systems and procedures:
  - ◊ Are in compliance with Agency requirements;
  - ◊ Can reasonably be implemented at the project; and
  - ◊ Are reasonably tailored to the particulars of the project.

Within 30 days of receipt of information from the borrower/management agent, the Agency will inform the borrower of its decision in writing.

If the Agency grants approval, the borrower may enter into a contract with the management agent to begin no sooner than 45 days from the date of submission of the approval package.

If the Agency issues a denial, the borrower will be provided with appeal rights. The borrower may not enter into a formal agreement with the management agent being reviewed by the Agency. If a borrower enters into an agreement with a management agent or begins to self-manage prior to receiving Agency approval, the Agency will place the borrower in nonmonetary default status. The Agency will ask the borrower, if not in a self-management arrangement, to immediately terminate the contract with the management entity. Under emergency circumstances, with Agency consent, the borrower may enter into a temporary agreement with a different management entity for 30 days.

### **C. Use of Management Entities without Agency Approval**

If a borrower enters into an agreement or contract with a management entity that has not been approved by the Agency, the Agency is authorized to immediately terminate the borrower's agreement or contract with that entity. This action is not appealable.

### 3.7 REMOVAL OF A MANAGEMENT AGENT

As permitted in the management certification, the Agency reserves the right to remove the management agent for lack of performance or deliberate fraud against the project or the Government. Some specific reasons for requiring removal of a management agent are listed in Exhibit 3-4. Other reasons also may apply.

<b>Exhibit 3-4</b> <b>Specific Reasons for Requiring Removal of a Management Agent</b>	
A. Lack of performance:	<ul style="list-style-type: none"> <li>• Failure to adhere to the provisions of the management certification;</li> <li>• Repeated failure to adhere to the management plan; and</li> <li>• Noncompliance with applicable state and local laws.</li> </ul>
B. Fraud against the project and/or Government:	<ul style="list-style-type: none"> <li>• Misappropriation of project funds;</li> <li>• Paying kickbacks to contractors, subcontractors, or service providers; and</li> <li>• Deliberately requesting more Rental Assistance than that to which the project is entitled.</li> </ul>

If the Agency determines that the management agent is in violation of the management certification, the Agency will:

- Send a servicing letter, *Handbook Letter 301 (3560), Servicing Letter #1*, notifying the borrower of the violation;
- State that the management agent must prove that there was no violation or that there were mitigating circumstances, and the borrower must respond to the Agency within 30 days of the receipt of the servicing letter;
- If the borrower does not respond satisfactory within the prescribed time period with either (1) documentation that the violation did not take place, or (2) a plan to address the violation within a certain period of time that is acceptable to the Agency, the Agency will send the borrower a second servicing letter, *Handbook Letter 302 (3560), Servicing Letter #2*; and
- If the borrower does not respond within the prescribed time period in the second servicing letter, the Agency will send a third servicing letter, *Handbook Letter 303 (3560), Servicing Letter #3* indicating that the management certification will be terminated by a certain date. As of that date, no management fees may be paid to the agent from project funds. If the information reveals that management fees were paid to the agent subsequent to termination of the management certification, the borrower will be required to reimburse the funds to the project operating account.

If the borrower is required by the Agency to remove the management agent, they must do so under the timeframe required by the Agency or file an official appeal, as described in Chapter 1, stating why they believe the agent should not be removed. Failure on the part of the borrower to comply with Agency demands to remove the agent may result in acceleration of the loan and debarment from further participation in Agency programs.

### **3.8 REVIEW OF A MANAGEMENT AGENT AND ONSITE MANAGEMENT**

#### **A. Central Office Reviews**

In some cases, agents with more than one property perform certain management functions from a centralized location. General management functions, as well as financial management and selected occupancy functions, are activities these agents often choose to centralize. Agency staff must perform management reviews of the agent's central office activities, as well as regular onsite reviews of functions carried out at the projects. The purpose of the centralized review is to limit the time spent reviewing individual properties. For example, once a review is performed on the agent's central office books, records, and internal controls, these items will not need to be inspected at each individual property.

When a management firm operates in more than one servicing jurisdiction in a state, the State Office has the responsibility for coordinating centralized reviews. They may solicit assistance from the Servicing Office that is located closest to the central office proposed for review. The State Office has the responsibility for ensuring the review is conducted, resolving any outstanding findings, and forwarding a copy of the review to other Servicing Offices with properties managed by that agent.

Central office management reviews should be performed at least once every 3 years. Findings from that review will be valid for any supervisory visit conducted during that time.

When a management firm operates in more than one state, states may elect to coordinate this review separately or may jointly choose one state to conduct the review. If one state will coordinate the review, typically the state in which the management agent's home office is located has this responsibility. It is encouraged that a member from the other state(s) participates in the review.

Whenever possible, a team of Agency staff with particular expertise, rather than a single staff member, should perform these reviews. An ideal team would consist of a Loan Servicer and individuals with expertise in financial management and occupancy requirements, if staffing permits. Additional members may be appropriate depending on the size of operation and types of functions handled by the agent's central office.

Central office management reviews follow a modified management review format. Agency staff performing this type of review should review the following items for compliance with the management plan and management certification including, but not limited to:

- Management agent level and financial review;
- Occupancy and tenant selection (those items that correspond to activities handled at the agent's central office), including drug-free housing policy;
- General management of project and physical and financial operation;
- IOI transactions; and
- Insurance deductibles and cost proration.

In completing the review, Agency staff should assess whether the agent's procedures allow the Agency to examine the performance of each project individually for all applicable listed items.

### **B. Onsite Management Reviews**

Onsite reviews of management agent performance will be performed using the procedures described in Chapter 9.

## **SECTION 3: SETTING THE MANAGEMENT FEE [7 CFR 3560.102]**

### **3.9 THE MANAGEMENT FEE**

#### **A. The Purpose of the Management Fee**

The purpose of the management fee, which is an allowable expense paid for out of the housing project's general operating account, is to compensate the management agent for services provided to the project. These services are detailed further in **Attachment 3-C**.

#### **B. Types of Management Fees**

There are two major types of fees that, when added together, make up the overall management fee for a project:

- Occupied unit fee; and
- Add-on fees.

The occupied unit fee is the largest component of the management fee. It must be quoted and calculated as a per-unit, per-month (pupm) fee for units occupied during a given month. This requirement gives the agent an incentive to maximize occupancy.

Add-on fees are quoted as dollar-per-unit amounts because they relate to project conditions that are not a function of project occupancy.

### ***1. Occupied Unit Fee***

Base fees will be established on a state-by-state basis. These fees will be based on the Agency's research on fees charged to manage other assisted housing of various types—elderly, family, cooperative, group homes—in the state. The Agency will use available data from recognized nationwide sources to determine appropriate fee levels.

Agents will be eligible to receive the full pupm fee for any month or part of a month during which the unit is occupied. State Offices can make adjustments to the fees approved by National Office by:

- Surveying comparable types of unassisted housing (e.g., elderly, family, cooperative, group homes) to determine the average management fee for the state; and
- Meeting with industry groups to obtain input and the fees established by the National Office.

Above a certain threshold, any modification to the National Office's established fees must be published and circulated to all borrowers. When the Agency determines these thresholds, they will be published along with the established fees.

### ***2. Add-On Fees***

Add-on fees are a flat dollar-per-unit fee paid to agents managing projects with long-term project characteristics and conditions that require additional management effort beyond the activities covered by the residential management fee. For example, scattered-site projects will often require greater management effort than single-site projects.

- The National Office will establish a standard list of add-on fees that will be applicable to all states.
- Exhibit 3-5 lists examples of project characteristics or conditions that may warrant the use of add-on fees.

Add-on fees should not cover project characteristics or conditions that are already covered in the base fee. Agents may not take add-on fees for management of properties with workout agreements except under limited circumstances, and solely at the Agency's discretion. If it is demonstrated that conditions at the property are beyond the management agent's control, the Agency may agree to allow the management agent to take add-ons fees for the circumstances listed in Exhibit 3-5. The Agency's decision may not be appealed.



**Exhibit 3-5****Examples of Circumstances Under Which  
Add-On Fees May Be Used**

- Management of properties with 16 units or less;
- Management of scattered sites in multiple communities;
- Management of properties with more than one type of project-based subsidy;
- Management of various types of properties (congregate care, family);
- Management of properties in a remote location; and
- Troubled properties with workout plans and new management only.

**C. Management Fee Conversions**

If management agents are charging a fee calculated as a percentage of the amount of income collected by the projects, the Agency will require them to convert to pupm fees.

For properties converting from a percentage fee to a pupm fee, the percentage fee should be translated to a per-unit level using the average vacancy rate over the last 12 months.

The examples show how management fees would be calculated under the new pupm system for the project described in the previous example. As stated above, a management fee may be collected for each unit that is occupied for all or part of a given month.

Under the new system, the management agent would be eligible to receive a management fee equal to the greater of the Agency-approved standard or \$22.80 for each occupied unit per month, until such time as the Agency-approved standard exceeds the amount of the capped management fee. If at the time of transition, the management agent's fee exceeds the regional cap, the agent may not increase its fee until the regional cap exceeds the management agent's transitional fee.

**D. Services Paid from the Management Fee**

The purpose of the management fee is to compensate the Agent for providing oversight to the project including:

**Examples- Management Fee Conversion**

A 50-unit property has a gross rent potential of \$20,000 per month, or \$240,000 per year. The average vacancy rate for the last 12 months is 5%. The current management fee is 6%. The pupm fee would be calculated as follows:

$$\begin{aligned} \$20,000 \times .95 &= \$19,000 \\ \$19,000 \times 6\% &= \$1,140 \\ \$1,140 \div 50 \text{ units} &= \$22.80 \text{ pupm} \end{aligned}$$

A 50-unit property has basic rents of \$400 per unit. In a particular month, one unit was vacant for the entire month and one was vacant from the sixteenth to the thirtieth day of the month. The management fee, at \$22.80 per month, would be as follows:

$$\$22.80 \times 49 = \$1,117.20$$

- Overseeing compliance with National, state, and local laws and regulations;
- Establishing strong project management policies and procedures; and
- Overseeing the implementation laws, regulations, policies, and procedures through the supervision of onsite staff.

A breakdown of items that are to be paid from the management fee can be found in *Form RD 3560-13* or **Attachment 3-C**.

The management fee should only cover the elements listed in *Form RD 3560-13*. When the bundle of services for which a management fee is currently paid is different from the bundle of services defined by the Agency or when the basis for the fee is different than the per-occupied unit, per-month basis defined by the Agency, the Agency will allow for a transition period to minimize impact of the conversion to the new method. Borrowers may follow this process or may simply convert to the new method. To translate a bundle of services management fee to be consistent with the bundle of services defined by the agency, the borrower/management agent should use the following process:

- Determine the elements covered in the current bundle of services and to which budget line items from *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* they correspond.
- Use the bundle of services management fee from the most recent annual financial statements, and divide it into its various components or budget line items. For example, if the agent's current management fee includes the salary for the resident manager, photocopier lease payments, photocopier expenses, office expenses, and bank fees, these amounts must be separated from the current management fee into the appropriate line items to arrive at the new management fee. To the extent possible, the line item amounts should be supported by invoices or similar documentation. If an invoice represents expenses of more than one project, the proration between properties should be documented.
- Calculate the new management fee by using the lump sum amount after deductions have been made for the other line items.
- Determine the pupm management fee by dividing the lump sum amount by the number of units in the property. Divide the quotient by 12 to arrive at the new pupm management fee.

An example demonstrating implementation of this process is included in **Attachment 3-E**.

Regardless of what services are included in the bundle of services fee, the actual management fee amount—net of other expenses paid—should be the same. The

management fee under the Agency defined bundle of services would only be smaller if the pupm amount exceeded the state cap.

#### **E. Services Paid from Project Income**

In general, project income is used to pay for project-related items. Examples include the salary, benefits, and office expenses of onsite office staff and maintenance expenses for the property and costs for processing project-specific transactions (e.g., tenant certifications). A specific breakdown of items that are to be paid from project income as opposed to the management fee can be found in **Attachment 3-D**.

The borrower and management agent must obtain materials, supplies, utilities, and services at a reasonable cost and seek the most advantageous terms for the project. The borrower or management agent must credit any rebates, fees, proceeds, or commissions generated by transactions using project funds to the project.

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## **SECTION 4: INSURANCE, BONDING, AND TAXES [7 CFR 3560.105]**

### **3.10 OVERVIEW**

Insurance protects the asset against loss or damage. Borrowers without adequate insurance coverage are financially responsible for:

- Property damage;
- Losses due to employee dishonesty or error; and
- Personal injuries that occur on the property.

Borrowers are responsible for acquiring and maintaining insurance on all dwellings and buildings that are necessary for the operation of the project in accordance with their loan or grant documents. Insurance must be in place at loan closing and must remain in place until the loan is paid in full. Reevaluation of insurance coverage is necessary when new buildings are constructed or values increase or decrease materially. Any refund or rebate from the insurance company must be credited to the project's account.

The Servicing Office is responsible for counseling the borrower regarding the Agency's insurance requirements and ensuring borrower compliance. The Agency will obtain insurance for the secured property if the borrower is unable or unwilling to do so. If a borrower refuses to pay the insurance premium with their own funds or fails to arrange with the agent for subsequent payment by premium note or otherwise, the Agency will pay the amount of the insurance premium and charge the premium payment amount and all costs associated with procurement of the required insurance to the borrower's Agency account. The Agency considers a borrower's failure to maintain adequate insurance coverage or to pay taxes as nonmonetary default. Borrowers who fail to furnish property and hazard insurance coverage of any kind are responsible for the debt in the event of loss.

### **3.11 PROPERTY INSURANCE**

Property or "all-risk" insurance protects the physical asset against loss due to damage. Types of property insurance are described below.

#### **A. Hazard Insurance**

##### ***1. Loss or Damage Covered***

Hazard insurance protects the property against fire and weather-related damage, as well as damage from civil commotion, aircraft, or other vehicles. These policies may also be known as fire and extended coverage, homeowners, all physical loss, or broad form policies.

## **2. Coverage Requirements**

The minimum property insurance coverage per building is 100 percent of the insurable value as reflected in the appraisal report, as referenced in Chapter 7 of HB-1-3560. If no appraisal report is required, the Agency will perform the necessary evaluations and determine and document the minimum insurance coverage requirements in the file.

## **3. Deductible**

If a property's insurance policy has a deductible, the deductible must be accounted for in the reserve account, unless the deductible does not exceed:

- \$1,000 on any project with an insurable value under \$200,000; or
- One-half of 1 percent of the insurable value, up to \$10,000 on a project with an insurable value over \$200,000.

## **B. Flood Insurance**

### **1. Loss or Damage Covered**

Flood insurance protects the property against flooding caused by natural disasters such as hurricanes. This coverage is required only for those properties located in areas identified as flood hazard areas.

### **2. Coverage Requirements**

Flood insurance is required for any property located in a Special Flood Hazard Area (SFHA), as identified by the Federal Emergency Management Agency (FEMA). *FEMA Form 81-93, Standard Flood Hazard Determination* is used to determine if a property is in a SFHA and whether flood insurance is available under FEMA's National Flood Insurance Program. If the property is in a SFHA, the Agency will notify the borrower using *Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*. The borrower must sign and return *Form RD 3550-6* prior to loan closing. If the borrower cannot secure flood insurance through FEMA's National Flood Insurance Program in a SFHA, the property is not eligible for Federal financial assistance.

### **3. Deductible**

The Agency allows a maximum deductible of \$5,000 per building.

## **C. Earthquake Insurance**

### ***1. Loss or Damage Covered***

Earthquake insurance covers property losses in the event of an earthquake. Earthquake coverage is recommended in areas where earthquakes are prevalent; however, it is very expensive and generally has a high deductible.

### ***2. Coverage Requirements***

Although the Agency does not specifically require a project to be covered by earthquake insurance, it recommends a Probable Maximum Loss (PML) seismic study for all projects located in certain regions of the country where earthquakes are prevalent. The coverage amount should be for 100 percent of the replacement cost of the project.

### ***3. Deductible***

In the event that the borrower obtains earthquake coverage, the Agency is to be named as a loss payee. The deductible should be no more than 10 percent of the coverage amount.

## **D. Windstorm Insurance**

### ***1. Required Coverage***

The windstorm policy should include extended coverage for rental loss for at least 12 months, except for coverage provided by State insurance programs.

### ***2. Deductible***

When windstorm coverage is excluded from the “all risk” policy, the deductible must not exceed 5 percent of the total insured value.

## **E. Builder’s Risk Insurance**

Builder’s risk insurance protects the property against loss or damage during construction or reconstruction after an insured loss.

## **F. Elevator, Boiler, and Machinery Insurance**

### ***1. Loss or Damage Covered***

Elevator, boiler, and machinery coverage may be required for any property that operates elevators, steam boilers, turbines, engines, or other pressure vessels.

## ***2. Coverage Requirements***

The Agency requires boiler and machinery insurance in any property that has centralized Heating, Ventilating, and Air-Conditioning (HVAC) equipment in operation.

## **G. Sinkhole Insurance or Mine Subsidence Insurance**

### ***1. Loss or Damage Covered***

Sinkhole insurance or mine subsidence insurance is recommended for projects located in areas prone to these geological phenomena.

### ***2. Coverage Requirements***

The amount of coverage that the Agency recommends for properties located in areas prone to these geological phenomena is 100 percent of the replacement cost of the structure affected.

### ***3. Deductible***

The deductible for sinkhole insurance or mine subsidence insurance should be similar to what would be required for earthquake insurance.

## **H. Business Income or Rent Loss Insurance**

### ***1. Loss or Damage Covered***

Business income or rent loss coverage provides coverage for the loss of rental income incurred due to a property loss during a 12-month period.

### ***2. Coverage Requirements***

The Agency does not require but recommends that the project be insured against loss of business income or rent in the event of a property loss that causes one or more units to be uninhabitable for a period of time. Business income coverage may be obtained in one of two forms:

- Actual loss sustained; or
- A fixed amount equal to the annualized amount of monthly gross potential rents.

## **I. Acceptable Exclusions**

Acceptable exclusions from “all risk” insurance policies include:

- War or military action;
- Nuclear hazard;



- Volcanic eruptions;
- Fraudulent or dishonest acts committed by the insured;
- Dispersal, release, or escape of contaminants or pollution (biological or chemical agents); and
- Terrorism.

#### **J. Property Insurance Exemptions**

Property insurance is not required if:

- The building is in such a state of disrepair that the cost of insurance would be prohibitive;
- The building has a depreciated replacement value of \$2,500 or less

#### **K. Property Insurance Policy Requirements**

The project's property insurance policy must include the following:

- **Name and location.** The policy should contain the names of the borrowers who are owners of the property being insured. The exact location of the property should be described in the policy.
- **Loss or damage covered.** The policy must indicate that the buildings are insured against loss or damage by fire, smoke, lightning, windstorms, hail, earthquake, explosion, riot, civil commotion, aircraft, and vehicles.
- **Effective date of insurance.** If there are insurable buildings located on the property, the policy's effective date will be on or before loan closing or assumption, or before the credit sale is closed, so that the policy will properly insure the borrower and the mortgagees. When new buildings are erected or major improvements made to existing buildings, such insurance will be made effective as of the date materials are delivered to the property. The Agency will not advance loan funds for labor or materials until the borrower has furnished adequate insurance to protect the interest of the Agency.
- **Term.** The borrower must furnish insurance for a term of at least 1 year, with evidence that a full year's premium is paid. If the policy is the type that imposes an assessment only after a loss has occurred, the borrower must provide documentation from the insurance company that no assessment is owed. If the insurance policy is automatically renewable, the renewal clause must meet Agency requirements.
- **Loss payee.** The Agency must be named loss copayee on all properties where it holds first lien position, which means if there is a damage or loss, the insurance draft

will be made payable to the Agency. Further, the Agency must be named as an additional insured if its lien position is other than first.

- **Mortgage clause.** The standard mortgage clause adopted by the State or the Agency *Form RD 426-2, Property Insurance Mortgage Clause (Without Contribution)* must be attached to or printed in the insurance policy. Whenever a new mortgage clause highlighting the Agency's interest is issued after the policy has been in force, the new mortgage clause must be signed by an authorized agent or officer of the company that issued the policy.

The mortgage clause is not required if:

- ◇ An authorized official of an insurance company provides a statement that all insurance policies the company issues in the state, and in which Rural Development has a mortgage interest, incorporate all of the provisions of *Form RD 426-2*. This statement may be accepted in lieu of attaching the form to each policy. If such a blanket letter is used, Rural Development must be named in the loss payable clause and a state instruction will be issued authorizing the use of this method after prior approval is obtained from the Agency.
- ◇ For all hazard and flood insurance policies the Agency will be named as copayee.
- ◇ For builder's risk policies the borrower must be named as the insured party, and the policy must convert to full coverage when the project is completed.

### 3.12 FIDELITY COVERAGE

#### A. Loss or Damage Covered

Fidelity insurance protects the property against loss due to employee dishonesty. The policy will provide coverage on all persons with access to project assets. Fidelity coverage may also be known as Blanket Crime Coverage or Fidelity Bond.

#### B. Coverage Requirements

The fidelity insurance policy, at a minimum, must include an insuring agreement that covers employee dishonesty. The minimum amount of fidelity coverage will be the amount calculated by multiplying an exposure index by a coverage factor. When the calculated amount is less than \$10,000, minimum coverage of \$10,000 must be provided. This calculation is made as follows (Exhibit 3-6):

- Determine exposure index: Exposure index = 25 percent of the SUM of annual cash receipts (rents, cash subsidy, interest, etc.) and cash (cash carryover, reserves, CDs, tax and insurance escrows, etc.). Round to next higher \$1,000.
- Determine coverage: Coverage = exposure index X coverage factor taken from the coverage chart shown in Exhibit 3-6. Round to next higher \$1,000.

<b>Exhibit 3-6</b>	
<b>Fidelity Coverage</b>	
<b>Exposure Index</b>	<b>Coverage Factor</b>
\$100,000 or less	0.30
\$100,000 to \$200,000	0.28
\$200,000 to \$300,000	0.26
\$300,000 to \$400,000	0.24
\$400,000 to \$500,000	0.22
\$500,000 to \$600,000	0.20
\$600,000 to \$700,000	0.18
\$700,000 to \$800,000	0.16
\$800,000 to \$900,000	0.14
\$900,000 to \$1,000,000	0.12
\$1,000,000 or more	0.10

### C. Deductible

A deductible is designed to allow flexibility in balancing what the project can prudently pay from its own assets, at a time of loss, against the economy of annual premiums in its annual budget. The deductible levels shown in Exhibit 3-7 will meet Agency requirements. Each year borrowers must review and adjust, if necessary, their fidelity coverage.

<b>Exhibit 3-7</b>	
<b>Fidelity Coverage Deductible Levels</b>	
<b>Fidelity Coverage</b>	<b>Deductible Level</b>
Under \$50,000	\$1,000
Up to and including \$100,000	\$2,500
Up to and including \$250,000	\$5,000
Up to and including \$500,000	\$10,000
Up to and including \$1,000,000	\$15,000

### D. Exemptions

Fidelity insurance is not required under the following circumstances:

- When a loan is made to an individual or a general partnership, and that individual or general partner will be responsible for the project's financial activities. Individuals cannot bond against their own actions. For land trusts where the beneficiary is responsible for project management, the beneficiary is treated as an individual.
- For the general partners of a limited partnership, unless one or more of its general partners perform financial acts coming within the scope of the usual duties.

## **E. Policy Requirements**

Fidelity coverage must be documented on a bond form acceptable to the Agency. Fidelity coverage policies must state that the insurance company will provide protection to the insured against the loss of money, securities, and property through any criminal or dishonest acts by any employee acting alone or in collusion with others. The amount of indemnity will not exceed the amount stated in the declaration of coverage.

The portion of the insurance premium to cover project site employees and general partners is an eligible project expense. The premium paid by the management agent is part of the agent's management expense and cannot be claimed as a project expense. When a project site employee is covered under the management agent's fidelity policy, the pro rata portion of the premium covering the employee should be reflected in the management plan.

### **3.13 ERRORS AND OMISSIONS INSURANCE**

Errors and omissions (E&O) coverage protects the borrower against loss resulting from negligence, errors, or omissions committed by those persons covered under the borrower's fidelity insurance policy. Obtaining E&O insurance does not diminish or limit the borrower's documentary obligations and responsibilities.

### **3.14 LIABILITY INSURANCE**

#### **A. Loss or Damage Covered**

This coverage insures against any personal injury that might occur in or on the project's common areas, common elements, commercial space, and public areas.

#### **B. Coverage Requirements**

The coverage must meet the requirements established below.

##### ***1. Commercial General Liability***

The insurer's limit of liability per occurrence for personal injury, bodily injury, or property damage under the terms of coverage must be at least \$1,000,000. Coverage may also include borrower exposure to risks such as E&O and environmental damage, or protection against discrimination claims.

##### ***2. Umbrella Liability Insurance***

The Agency recommends, but does not require, the borrower to obtain umbrella liability insurance to provide coverage over and above the \$1,000,000 provided for in the commercial general liability policy. The Agency recommends that umbrella liability insurance policies provide coverage as follows:

- For projects with buildings of 1 to 3 stories, \$1,000,000;
- For projects with buildings of 4 to 10 stories, \$5,000,000; and
- For projects with buildings of 11 to 20 stories, \$10,000,000.

### ***3. Commercial Automobile Liability Insurance***

The Agency recommends that the borrower purchase commercial automobile liability insurance to cover all automobiles used for business purposes related to the project. The recommended amount of coverage is \$1,000,000 per occurrence.

#### **C. Deductible**

The Agency allows a deductible not to exceed \$5,000 per occurrence.

### **3.15 WORKERS' COMPENSATION**

This insurance coverage, which is also known as employer's liability coverage, is required by the Agency.

### **3.16 POLICY RENEWALS**

Renewal of insurance will be monitored through the borrower's annual reporting process. When renewing insurance policies, if the best policy the borrower can obtain contains a deductible clause with amounts greater than those stated above, the borrower must submit to the Agency:

- The insurance policy; and
- An explanation and documentation that more adequate insurance coverage was not available.

### **3.17 BLANKET POLICIES**

Blanket insurance policies for several buildings or properties located on noncontiguous sites are acceptable if the insurer provides proof that the secured property is as fully protected as if a separate policy were issued.

Blanket crime insurance coverage or fidelity bonds are acceptable types of fidelity coverage. At a minimum, a borrower must provide the Agency with an endorsement listing all Agency properties and their locations covered under the policy or bond as evidence of required fidelity insurance. The policy or bond may also include properties or operations other than Agency-financed properties on separate endorsement listings.

Individuals or organizational borrowers must have fidelity coverage when they have employees with access to Multi-Family Housing complex assets. A borrower who uses a management agent with exclusive access to housing assets must require the agent to have fidelity coverage on all principals and employees with access to the project. If project management reverts to the borrower, the borrower must immediately obtain fidelity coverage.

### **3.18 AUTHORIZED INSURANCE PROVIDERS**

Borrowers are responsible for selecting an insurance provider that meets Agency requirements. The insurance provider must be licensed or authorized to do business in the state or jurisdiction where the project is located. In making the determination that an insurance company is reputable and financially sound, the Agency uses all relevant available information, including financial statements, Best's Insurance Reports, and information from state insurance authorities.

The borrower and management agent are required to disclose any IOI relationships with the insurance company.

### **3.19 BORROWER FAILURE TO MEET INSURANCE REQUIREMENTS**

The Servicing Office is responsible for taking all actions in connection with insurance that are necessary to protect the security interest of the Agency. Any unusual situation that may arise with respect to borrower procuring or maintaining insurance should be referred to the State Director. The State Director may refer questions to the Office of General Counsel (OGC).

#### **A. Unacceptable Insurance Policy**

When the borrower submits a policy or binder that does not meet Agency requirements, the Field Office Staff will return the policy/binder to the borrower with a form letter that provides the reasons for the policy's unacceptability and requires an acceptable policy within 30 days of the date of the letter.

In cases where the borrower cannot obtain the required insurance, the Servicing Office will attempt to provide the borrower with a list of authorized insurance providers. After the Servicing Office and the borrower exhaust all efforts to obtain acceptable insurance, the Loan Servicer will request advice from the State Office about companies issuing acceptable policies in the State and from which the borrower might be able to obtain an acceptable policy. If acceptable coverage still cannot be obtained from an authorized provider and the determination has been made to continue with the borrower, the Loan Servicer will temporarily accept from the borrower the available insurance policy the Agency determines most nearly conforms to established requirements. Whenever adequate insurance becomes available, the State Director will require the borrower to deliver to the Servicing Office an acceptable insurance policy.

#### **B. Expired Policies**

When an expired insurance policy is not renewed, the Loan Servicer will request the insurance agency or broker who issued the expired policy to issue a new policy. The new

policy will be effective as of the date of the Loan Servicer's contact with the insurance agency or broker or as soon as possible thereafter, and will be for a term of 1 year. The Agency will be shown in the loss payable clause and in the mortgage clause in the proper order of priority. Insurance coverage on each building usually will be the same as shown on the expired policy if it meets or exceeds Agency requirements. If the coverage shown on the expired policy does not meet Agency requirements, proper coverage will be obtained. The Loan Servicer will, if possible, have an automatic renewal provision included in the policy. If the insurance agency or broker who issued the expired policy refuses to issue a new policy, the Loan Servicer will have the borrower designate in writing another insurance agency or broker from whom the insurance can be obtained.

### **C. Force-Placed Insurance**

If the borrower does not furnish acceptable insurance within the required timeframe the Loan Servicer will begin the process of procuring the required insurance. The costs of procuring the insurance and the premium amount will be added to the borrower's Agency account.

## **3.20 PROPERTY DAMAGE OR LOSS**

Borrowers must notify the Agency and their insurance company agents of any loss or damage to the insured property.

### **A. When Loss or Damage is Discovered**

Upon being notified of loss or damage, the Loan Servicer will:

- If the Agency is listed as mortgagee in the insurance policy, collect the amount of the loss and may also consent to the borrower using the funds to repair or replace damaged or destroyed property or to apply the loss proceeds to their loan account or to any prior liens that might exist in the order of their priority;
- If the Agency is not listed as mortgagee in the insurance policy, contact the borrower to determine whether they have received the loss proceeds. If the borrower has received the loss proceeds but has not yet paid for improvements to repair or replace the property, or has not received the loss proceeds, the Loan Servicer will:
  - ◊ Inform the borrower of their responsibility for repairing or replacing the damaged or destroyed property or for authorized disposition of the loss proceeds; and
  - ◊ Notify the insurance company in writing of the Agency's interest in the security property and request that the loss proceeds be made payable jointly to the Agency and the borrower.

## **B. Loss Drafts**

A loss draft is payment from the insurance provider for property loss or damage. Loss drafts for loans secured by a first mortgage, which in the opinion of the Agency represents a satisfactory adjustment of the loss will be endorsed immediately without recourse and deposited in a supervised bank account to be used in repairing or replacing the damaged building, except when:

- The amount of the loss is \$5,000 or less and the borrower will use the funds for repairing or replacing an essential building. The loss draft may be endorsed without recourse and given to the borrower upon satisfactory proof that the repairs or replacements have been made, or upon satisfactory assurance that the work will be performed.
- The essential buildings are not to be repaired or replaced and other suitable buildings are not to be erected.
- A balance remains after all repairs, replacements, and other authorized disbursements have been made, insurance funds can be applied as follows:
  - ◊ To prior liens;
  - ◊ As an extra payment to the borrower's loan account; or
  - ◊ To the borrower's reserve account.
- The indebtedness secured by the insured property has been paid in full or the draft is in payment for loss of property on which the Agency has no claim. A loss draft that includes the Agency as a joint payee may be endorsed without recourse and delivered to the borrower.

Loss drafts for a loan that is not secured by an Agency first mortgage will be released by the Agency only if the primary mortgagee agrees to the provisions set forth in the previous part.

## **3.21 REAL ESTATE TAXES**

Borrowers are responsible for paying real estate taxes each year. The annual financial statements must include a certification that the property's real estate taxes have been paid. Failure to pay taxes and assessments when due will be considered a nonmonetary default.

When the Agency discovers that a borrower has failed to pay property taxes or local assessments, the Loan Servicer will notify the borrower in writing to pay the property's taxes and that paying taxes are the borrower's responsibility. The notification letter will request proof of payment of taxes within 30 days. If the borrower fails to submit proof of payment, the Loan Servicer will:



- Determine if taxes have been paid;
- Pay delinquent taxes and any penalties;
- Charge the cost of bringing the taxes current to the borrower's Agency account; and
- Require the borrower to establish an account to ensure that funds are available for payment of taxes.

The Loan Servicer will begin servicing actions.

## **SECTION 5: PROJECT MANAGEMENT FOR LABOR HOUSING**

### **3.22 PROJECT MANAGEMENT AND FEES**

#### **A. Off-Farm Labor Housing**

Project management for off-farm labor housing will be in accordance with the procedures established in this chapter for the Section 515 program. Borrowers are required to submit a management plan and a management certification, and to receive Agency approval on the proposed management agent and the management fee prior to paying a management fee from project income. For off-farm labor housing operated on a seasonal basis, the management plan must establish specific opening and closing dates.

#### **B. On-Farm Labor Housing**

Project management for On-Farm Labor Housing projects should follow the same basic procedures as outlined in this chapter for the Section 515 program with the following exceptions:

- On-Farm Labor Housing borrowers are expected to manage their own properties and should not need to charge a fee for this service; and
- On-Farm Labor Housing borrowers are required to maintain a lease or employment contract with each tenant specifying employment with the borrower as a condition for continued occupancy.

### **3.23 INSURANCE REQUIREMENTS**

#### **A. Off-Farm Labor Housing**

Off-farm labor housing must comply with the same insurance requirements as specified for the Section 515 program in this chapter.

#### **B. On-Farm Labor Housing**

On-Farm Labor Housing borrowers must ensure that they provide hazard insurance adequate to cover replacement of the property in case of loss. On-Farm Labor Housing

borrowers must comply with the same flood insurance requirements as specified in Paragraph 3.11 B.

## **ATTACHMENT 3-A**

### **BORROWER CERTIFICATION THAT NO CHANGES ARE REQUIRED TO THE MANAGEMENT PLAN**

(To be submitted once every 3 years if no changes are needed to the management plan during that period)

I, \_\_\_\_\_, certify that there have been no changes in the project's operations during the last 3 years, that the project operations are consistent with the current management plan, and that the plan is adequate to ensure project compliance with the loan documents and the applicable Agency requirements.

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(Borrower)

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## ATTACHMENT 3-B

### FREQUENTLY ASKED QUESTIONS (FAQ)

#### NONDISCRIMINATION POLICIES AND PRACTICES BORROWERS MUST ADDRESS

- How will applicants and tenants be made aware that the owner will provide reasonable accommodations (unless doing so would cause an undue administrative burden)?
- How will requests for reasonable accommodations be handled and who is authorized to approve or deny any such requests?
- Does the project have a Telecommunication Device for the Deaf (TDD) or an *equally effective communication system*? (Note: If the complex has Section 8 assistance from HUD, the complex is required to have a TDD)
- If the project has a TDD, is the public made aware that there is a TDD? For example, is the TDD telephone number given each time the project's telephone number is given?
- If the project relies on a relay service as an *equally effective communication system* (rather than having a TDD), who operates the relay service? Is the relay service available 24 hours a day and without any added cost to the disabled person?
- Have procedures been established to accommodate hearing- and sight-impaired applicants and tenants? Examples of methods the borrower might use include readers, sign language interpreters, Braille, etc.
- Does management give priority for fully accessible units to persons who are in need of the special design features of an accessible unit? Is priority given first to those living in the complex and then to persons on the waiting list?
- Before accessible units are temporarily rented to people who do not need the special design features, have there been diligent marketing efforts to market the units as accessible units? Have those efforts been documented? Are lease clauses used? Do marketing efforts continue after renting the unit to someone who does not need the special design features?
- Is management's policy for verifying a person's disability limited to only that which is needed to establish eligibility and is verification required only after a tenant or applicant has asked that their disability be considered by management?
- Does management provide their employees with civil rights training?

- When marketing an elderly project, has there been an effort to reach all eligible people? Persons with disabilities (of any age) are every bit as eligible as persons who are 62 or older. Marketing efforts should be designed to reach both population groups.
- Does the borrower/management agent notify the public that they do not discriminate on the basis of disability? Do materials published by the borrower contain such a notice? Use of the Equal Housing Opportunity logo is one means of doing so (the logo is the house with the equal sign and the words Equal Housing Opportunity underneath the house).
- Does management have a policy that permits persons with disabilities to have service and/or companion animals?
- Does management give persons with disabilities the same choices other applicants are given? For example, the choice to pick either first or second floor apartments.

**ATTACHMENT 3-C**  
**COSTS AND SERVICES TO BE PAID**  
**FROM THE MANAGEMENT FEE**

The following items and services are provided in return for the management fee:

- A. Supervision by the management agent and staff (time, knowledge, and expertise) of overall operations and capital improvements of the site.
- B. Hiring, supervision, and termination of onsite staff.
- C. General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all onsite employees including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and Workers' Compensation reports, and other IRS or state-required reports.
- D. Training provided to onsite staff at the project site.
- E. Preparation and submission of proposed annual budgets and negotiations for approval with RHS, HUD, or other governmental agencies and the borrowers.
- F. Preparation and distribution of RHS, HUD, Housing Finance Authority (HFA), or other governmental agency and normal financial reports to borrowers, RHS, HUD, HFA, or other governmental agency.
- G. Preparation and distribution of required year-end reports to RHS, HUD, HFA, or other governmental agency and borrowers.
- H. Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.
- I. Arrangement of preparation by outside contractors of Energy Audits and Utility Allowance analysis. Implementation of appropriate changes.
- J. Preparation and implementation of Affirmative Fair Housing Marketing Plans (AFHMPs) as well as general marketing plans and efforts.
- K. Reviews of tenant certifications and submission of monthly Rental Assistance requests, overage, and monies collected for occupancy surcharge. Submission of payments where required.
- L. Preparation, approval, and distribution of operating disbursements and oversight of project receipts and reconciliation of deposits.

M. Overhead of management agent including:

- Establishment, maintenance, and control of an accounting system adequate to carry out accounting supervision responsibilities.
- Maintenance of agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, RHS, HUD, HFA, or other governmental agency and with the borrowers and the main office.
- Postage expenses related to the normal responsibility for mailings to the properties, RHS, HUD, HFA, or other governmental agency, the tenants, the vendors and the borrowers.
- Expense of telephone and facsimile communication to the properties, tenants, RHS, HUD, HFA, or other governmental agency and the borrowers.
- Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.), directly related to protection of the funds and records of the borrower.
- Central office staff training and ongoing certifications.
- Maintenance of all required profession and business licenses and permits. (This does not include site office permits or licenses.)
- Insurance coverage for Agents office and operations (Property, Auto, Liability, Errors and Omissions (E&O), Casualty, Workers' Compensation, etc.).
- Travel of Agent staff to the properties for onsite inspection, training, or supervision activities.
- Agent bookkeeping for their own business.

N. Attendance at meetings (including travel) with tenants, borrowers, investors, and/or RHS, HUD, HFA, or other governmental agency.

O. Development, preparation, and revision of management plans and/or agreements.

P. Coordination of HUD certificates or vouchers with tenants including reporting to all pertinent agencies and borrowers.

Q. Direction the investment of project funds into required accounts.

R. Maintenance of bank accounts and monthly reconciliations.

S. Preparation, request for, and disbursement of borrower's initial operating capital (for new projects), as well as administration of annual return to borrower.



- T. Account maintenance, settlement, and disbursement of security deposits.
- U. Work with auditors for initial setup of audits and annually thereafter for audit preparation and review. Assistance with supplemental letters and preparation of *Form RD 3560-10, Borrower Balance Sheet*, as well as other RHS, HUD, HFA, or other governmental agency reports.
- V. Storage of records and adherence to records retention requirements.
- W. Assistance to onsite staff with tenant relations and problems. Assistance in severe actions (eviction, death, insurance loss, etc.).
- X. Oversight of general and preventive maintenance procedures and policies.
- Y. Development and oversight of asset replacement plans.
- Z. Oversight of preparation of Section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and Section 504 requirements.
- AA. Reporting to general and limited partners and State Agencies for LIHTC compliance purposes.

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## **ATTACHMENT 3-D**

### **COSTS AND SERVICES TO BE PAID FROM PROJECT INCOME**

There are some generally accepted project expenses that may be paid out of the project operating account. These expenses are listed below.

- A. Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. These will include managers, maintenance staff, and temporary help for both positions and can including the following specific items:
  - Gross salary;
  - Employer Federal Insurance Contributions Act (FICA) contribution;
  - Federal unemployment tax;
  - State unemployment tax;
  - Workers' compensation insurance;
  - Health insurance premiums;
  - Cost of fidelity or comparable insurance;
  - Leasing, performance incentive, or annual bonuses;
  - Direct costs of travel to offsite locations by onsite staff for property business or training; and
  - Retirement benefits.
- B. Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, all legal documents, and other project-related matters.
- C. All outside account and auditing fees, if required by RHS, directly related to the preparation of the annual audit, partnership tax returns, and Schedule K-1, as well as other outside reports and year-end reports to RHS, HUD, FHA, or other governmental agency.
- D. All repair and maintenance costs for the project, including:
  - Maintenance staffing costs and related expenses;
  - Maintenance supplies;
  - Contract repairs to the projects (heating and air conditioning, painting, roofing, etc.);

- Make-ready expenses, including painting and repairs, flooring replacement, and appliance replacement, as well as drapery/mini-blind replacement (turnover maintenance);
- Preventive maintenance expenses, including occupied units repairs and maintenance, as well as common area systems repairs and maintenance;
- Costs of snow removal;
- Costs of elevator repairs and maintenance contracts;
- Costs of Section 504 compliance;
- Costs of landscaping maintenance, replacements, and seasonal plantings;
- Costs of pest control services; and
- Other related maintenance expenses.

E. Specific costs that may be charged to the project include:

- The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.
- The costs of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.
- All bank charges related to the property including purchases of supplies (stamps, checks, deposit slips, returned check fees, service fees, etc.).
- Costs of site-based telephone, including initial installation, basic services, directory listings, and long distances charges.
- All advertising costs related specifically to the operations of that project. These can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.
- Postage and delivery costs from the site, including expenses to RHS, HUD, or other governmental agencies; tenants; verifying third parties; central management offices; etc.
- Partnership filing expenses, including state taxes and other mandated state or local fees, as well as other relevant expenses. Costs of continuation financing statements and site license and permit costs.
- Expenses related to site utilities, including actual costs and surcharges, as well as deposits and expense of utility bonds in lieu of bonds.

- Site office furniture and equipment including site-based computer and copiers. Service agreements and warranties for copiers, telephone systems, and computers are also included (if approved by RHS and make good business sense).
- Real estate taxes (personal/tangible property and real property taxes) and expenses related to controlling or reducing taxes.
- All costs of insurance, including property liability and casualty, as well as fidelity or crime and dishonesty coverage for onsite employees and the general partners.
- Costs of collecting rents onsite, including bookkeeping supplies and record keeping items.
- Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies, and other associated expenses.
- Public relations expenses related to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. For example, Chamber of Commerce duties, contributions to local charity events, sponsorship of tenant activities, etc.
- Tax Credit Compliance Monitoring Fees imposed by HFAs.
- All insurance deductibles, as well as adjuster expenses.
- Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation, and inspection contracts, etc.).
- Onsite training as preapproved by RHS.
- Site manager salary for additional hours associated with congregate housing.

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**ATTACHMENT 3-E**  
**CONVERSION OF MANAGEMENT FEES TO BUNDLE**  
**OF SERVICES DEFINED BY THE AGENCY**  
**(for borrower and/or management agent)**

**EXAMPLE**

ABC Management manages a 50-unit property. The new State cap for management fees is \$28 per-unit, per-month (pupm) amount.

The property's current annual gross potential rents are \$210,000. Included in its bundle of services fee are the following items:

- Actual fee for managing property;
- Resident manager's salary;
- Payroll taxes;
- Photocopier leases;
- Photocopier supplies;
- Postage, supplies for bookkeeping, computer, and basic office supplies; and
- Bank fees.

**Step 1: Determine elements covered by current bundle of services fee.**

ABC Management Company determined that the items covered under its bundle of services fee corresponded to the following line items:

- Management fee (corresponds to line item 20);
- Resident manager's salary (corresponds to line item 19);
- Payroll taxes (corresponds to line item 30);
- Workers' Compensation (corresponds to line item 31);
- Photocopier leases (corresponds to line item 27);
- Photocopier supplies (corresponds to line item 26);
- Postage and supplies for bookkeeping, computer, and office (corresponds to line item 26); and
- Bank fees (corresponds to line item 32).

**Step 2: Using the budget line items from *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* as a guide, divide the bundle of services fee into its various components. Use invoices to determine how much to deduct from the management fee for each item.**

Management fee (from most recent annual financial statements)	\$50,000
Resident manager's salary (line item 19)	\$22,000
Photocopier leases (line item 27)	3,000
Postage, supplies for bookkeeping, computer, photocopier, and basic office supplies (line item 26)	5,800
Payroll taxes (line item 30)	1,760
Workers' Compensation (line item 31)	2,000
Bank fees (line item 32)	<u>400</u>

**Subtotal: Deductions from Management Fee      \$34,960**

#### MANAGEMENT FEE CONVERSION

Line Item	Administrative Expense Category from <i>Form RD 3560-7</i>	Existing Bundle of Services Fee	New Management Fee
19	Site Management Payroll		\$22,000
20	Management Fee	\$50,000	\$15,040
21	Project Auditing Expense		
22	Project Bookkeeping/Accounting		
23	Legal Expenses		
24	Advertising		
25	Telephone and Answering Service		
26	Office Supplies		\$5,800
27	Office Furniture and Equipment		\$3,000
28	Training Expense		
29	Health Insurance and Other Employee Benefits		
30	Payroll Taxes		\$1,760
31	Workers' Compensation		\$2,000
32	Miscellaneous		\$400
	<b>TOTAL</b>	<b>\$50,000</b>	<b>\$50,000</b>

**Step 3: Calculate the new management fee by using the lump sum amount after deductions have been made for the other line items.**

Bundle of services management fee	\$50,000
Less: deductions	– 34,960
New lump sum management fee	\$15,040



**Step 4: Determine the pupm management fee by dividing the lump sum amount by the number of units in the property. Divide the quotient by 12 to arrive at the pupm management fee.**

$$\begin{aligned} \$15,040 \div 50 &= \$300.80 \\ \$300.80 \div 12 &= \$25.07 \text{ pupm} \end{aligned}$$

With the current bundle of services, the pupm fee would be as follows:

$$\begin{aligned} \$50,000 \div 12 &= \$4,166.67 \\ \$4,166.67 \div 50 &= \$83.33 \end{aligned}$$

The net amount of fee going to the management agent after all of the corresponding expenses are paid, however, would be the same in both situations.

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## **ATTACHMENT 3-F**

### **FREQUENTLY ASKED QUESTIONS (FAQ) CIVIL RIGHTS-RELATED COMPLIANCE ISSUES**

**1. Is the International Symbol of Accessibility (ISA) required to be on a MFH project sign?**

No. However, borrowers are encouraged to include the ISA on the project sign if:

- There are no physical barriers for someone wishing to inquire or apply for a service or benefit, and
- The project has an accessible route to fully accessible units.

**2. Is the Telecommunication Device for the Deaf (TDD) number required to be on the project sign?**

When project management communicates with hearing impaired applicants or tenants, they must use either a TTD or an “equally effective communication system.” If a borrower uses a TTD number, the TTD number must be on the project sign. If a borrower uses an equally effective communication system, the borrower must document the process in their self-evaluation and let the public know how this is to be accomplished. However, the borrower is not required to post the relay service phone number on the project sign. Borrowers with Section 8/515 projects are required by HUD to use a TTD.

**3. Are assistance animals that assist the disabled subject to MFH project “Pet” rules?**

No. They are permitted occupancy under the Fair Housing Act and are defined as follows:

- Assistance animals are not pets. These are animals that work, provide assistance, or perform tasks for the benefit of a person with a disability, or animals that provides emotional support that alleviates one or more identified symptoms or effects of a person’s disability. Assistance animals – often referred to as “service animals,” “support animals,” “therapy animals” or “companion animals” perform many disability-related functions including but not limited to (1) guiding individuals who are blind or have low vision, (2) alerting individuals who are deaf or hard of hearing to sounds, (3) providing minimal protection or rescue assistance, (4) pulling a wheelchair, (5) fetching items, (6) alerting persons to impending seizures, or (7) providing emotional support to persons with disabilities who have a disability-related need for such support.
- A borrower may not refuse to allow a person with a disability to have an assistance animal merely because the animal does not have formal training. Some, but not all, animals that assist persons with disabilities are professionally trained. The owners

themselves train other assistance animals and, in some cases, no special training is required. The question is whether or not the animal performs the disability-related assistance or provides the disability-related benefit needed by the person with the disability.

- A borrower's refusal to modify or provide an exception to a "no pets" rule or policy to permit a person with a disability to use and live with an assistance animal would violate Section 504 of the Rehabilitation Act of 1973 and the Fair Housing Act unless:
  1. The animal poses a direct threat to the health or safety of others that cannot be reduced or eliminated by a reasonable accommodation,
  2. The animal would cause substantial physical damage to the property of others,
  3. The presence of the assistance animal would pose an undue financial and administrative burden to the provider, or
  4. The presence of the assistance animal would fundamentally alter the nature of the provider's services.
- The fact that a person has a disability does not automatically entitle him or her to an assistance animal. There must be a relationship between the person's disability and his or her need for the animal.
- A borrower may not require an applicant or tenant to pay a fee or a security deposit as a condition of allowing the applicant or tenant to keep the assistance animal. However, if the individual's assistance animal causes damage to the applicant's unit or the common areas of the dwelling, at that time, the borrower may charge the individual for the cost of repairing the damage if the provider regularly charges tenants for any damage they cause to the premises.

**4. Does an applicant needing special design features have priority for occupancy over a current tenant without a need for the special design features of a fully accessible unit?**

Yes. While tenants without a need for the special design features may occupy a fully accessible unit, prior to occupancy the tenant must agree to move to another unit in the project if a qualified individual needing the special design features applies for occupancy of the fully accessible unit. Borrowers are required to enter into a lease agreement with the tenant without a need for the special design features to assure that a legal right exists to require the tenant to move to another available unit in the project, when necessary.

**5. What are a few suggestions to improve marketing of fully accessible units?**

Before fully accessible units are rented to persons not in need of the special design features, borrowers must conduct a diligent and documented marketing effort to ensure that those in need of the special design features know about the availability for the units. Such contacts may include, Area Commission on Aging, Physical Rehabilitation Centers, Hospitals and Disabled

Veterans Organizations. Borrowers are encouraged to use the handicap accessibility logo as a marketing tool on the project sign, in advertising, and on contact letters, leaflets and brochures. When a tenant not needing the design features occupies a fully accessible unit, borrowers are to continue their marketing efforts until a tenant needing the design features is found.

**6. How do borrowers meet 7 CFR 15b numerical requirements for fully accessible units?**

In MFH projects ready for occupancy after June 10, 1982, 7 CFR 15b standards require:

- At least 5 percent or one unit, whichever is greater, must be fully accessible. To meet the 5 percent minimum, borrowers must round up to the next whole unit. For example, a 24-unit MFH project must have at least two fully accessible units (8.3 percent) rather than one (4.2 percent).
- Fully accessible units must be comparable in variety to other project units. For example, in a 24-unit project with 12 one-bedroom units and 12 two-bedroom units, one of the fully accessible units should be a one-bedroom unit and the other should be a two-bedroom unit.
- Rents for fully accessible units must be comparable to other same sized project units.
- If a project has more than one site, fully accessible units may not be clustered at one site, unless only one fully accessible unit is required.
- When a project has a wide variety of units (one, two, three or four bedrooms), borrowers are not required to exceed the 5 percent requirement simply to have a fully accessible unit of each type.

**7. On-farm Farm Labor Housing is normally a single-family house. Is this housing subject to the 5 percent fully accessible requirement?**

No. The 5 percent requirement appears in 7 CFR 15b.41. This section of the regulation only applies to multi-family rental housing. The Office of the General Counsel (OGC) provided an opinion on its application to a single unit Farm Labor Housing because 7 CFR 15b does not define “multi-family.” OGC advised us that we may use the definition in Uniform Federal Accessibility Standards (UFAS), which defines multi-family housing as any “building containing more than two dwelling units.” (For more information on UFAS, refer to [www.access-board.gov/ufas/ufas-html/ufas.htm](http://www.access-board.gov/ufas/ufas-html/ufas.htm)). Therefore, “on-farm” labor housing that consists of buildings with less than three units, is not required to meet the requirement that 5 percent of the units be constructed as fully accessible units. However, borrowers should be mindful that if a request is made for a “reasonable accommodation”, that they must address accessibility at that time.

## **8. Who pays for reasonable accommodations?**

If an eligible applicant or tenant makes a request for a reasonable accommodation, borrowers are to use project resources to complete and pay for the accommodation. A borrower may deny such a request only when the accommodation would cause an undue financial/administrative burden, or a fundamental change in operations. The borrower alone is responsible for the consequences of such a determination. If the borrower takes this position, the applicant or tenant must be permitted to make the requested change at their own expense.

## **9. What type of reasonable accommodation is made?**

If an eligible applicant or tenant makes a request for a reasonable accommodation, the change to be made should be based on the tenant's assessment of their needs, even when the accommodation may vary from commonly accepted accessibility standards. All improvements should be done in a professional manner and meet local building code requirements.

## **10. When is it appropriate to make inquiries about a person's disability?**

An appropriate question for all applicants to an elderly MFH project is:

- “If you are less than 62 years old, are you eligible for occupancy based on your status as an individual with handicaps or disabilities?”

Regarding the issue of adjustments to income or priority for a unit with special design features, the application form should give the opportunity to make a request for the added benefit. For example, it would be appropriate to ask all applicants and tenants:

- “Do you wish to have priority for an apartment with special design features for persons with disabilities?”
- “Do you wish to claim a \$400 deduction from your income based on a disabling condition?”

By phrasing questions in this manner, applicants are advised of the benefit and allowed to decide for themselves if they wish to disclose a disabling condition. Once an applicant requests that their disability status be considered, inquiries can be made, but only to the extent necessary to verify eligibility. Project management should not attempt to make any determination concerning an applicant's disabling condition.

## **11. May a guardian sign a rental agreement on behalf of a qualified person with a disability?**

While there is no Federal law preventing a guardian from signing a rental agreement on behalf of a qualified person with disabilities, state law may vary. Each borrower should check with their legal counsel. To the extent individual state laws permit a guardian to sign a rental agreement, guardian signatures are to be accepted.

**12. What are the requirements for van accessible parking?**

The requirements vary based on when a project became ready for occupancy. See **Attachment A** and A-1 for a discussion of the applicable standards. The parking lot of all projects with public areas such as an on-site office, ready for occupancy after January 26, 1993, must be properly striped for van accessible parking and access aisles. All projects with public areas ready for occupancy before January 26, 1993, must be striped for van accessible parking and access aisles whenever the parking lot is re-striped.

**13. If accessible parking is located across the drive from the building it serves, must a crosswalk be painted on the drive?**

No, it's not required. However, having a crosswalk is a good idea since it would indicate a crossing exists, and hopefully would signal a driver to slow down. There is no requirement for a painted crosswalk in the accessibility standards. Further, there is no requirement for the color of paint to be used. White is most commonly used, and sometimes blue or yellow. Curb ramps from the drive to the site are required.

**14. May a borrower allow a resident assistant to occupy a unit overnight to assist a tenant with a disability?**

Yes. When a tenant with a disability provides a physician's statement requiring resident assistant care in excess of the established time periods for visitors, it would be a reasonable accommodation to the rules and policies to allow the resident assistant to reside in the unit in excess of established visitor's time. Further, if the need is for the resident assistant to live in the unit, it is a reasonable accommodation to rent a two-bedroom unit to a tenant at their request. The income of a resident assistant is not included in tenant household income.

**15. Is the "interested person(s)" who assists or is consulted during the borrower's preparation of their self-evaluation required to visit the project site?**

No. While interested persons, including disabled persons or organizations representing disabled persons must be consulted (see **Attachment C**) they are not required to conduct a site visit.

**16. Is the self-evaluation required to be maintained at the project site?**

Yes, if the project has an office. If there is no office, the borrower is still obligated to make the self-evaluation available to the public upon request. The public includes any applicant, tenant and the Agency. It is not reasonable for the borrower to expect the public to drive to a location other than the project to view the self-evaluation.

**17. What can be done with projects ready for occupancy after June 10, 1982 that were not built in accordance with UFAS standards, where it is either structurally impractical or financially infeasible to make the required changes?**

Typically, the borrower should seek guidance from their project architect before making this determination. The Agency will need documentation that it is structurally impractical from a knowledgeable source. For example, in a project built using a split foyer design, it may be structurally impractical to make changes. The borrower might try to establish a referral agreement with another project in the local market area with a fully accessible unit. If no referral agreement is possible to make the program accessible, the Agency may administratively recognize that the borrower is unable to address their outstanding non-compliance issues. In this case, all avenues have been explored, and the Servicing Office will document the case file to fully explain the situation and the borrower's attempts to resolve the problem, remove the finding(s) from Multi-Family Housing Information System (MFIS) and discontinue reporting the situation through the post supervisory visit and compliance review reporting process.

In some instances, a borrower may claim that a project is not able to meet UFAS standards because the project's financial condition is such that the change would create an undue financial burden. For example, the project is located in a poor rental market and rents are insufficient to address capital needs. While the Agency has no mechanism for waiving the requirements of UFAS standards for financial reasons, the borrower may request a waiver from the Secretary of Agriculture. For such a waiver, the borrower must document the financial condition of the project as well as attempts to seek local, state, private and Federal funding for grants or loans to correct the condition.

**18. Attachment C states that regardless of when a project was ready for occupancy, all borrowers are required to have "policies and practices" that do not discriminate against persons with disabilities which are provided on Attachment C-1. Where do the borrowers document these "policies and practices"?**

Borrowers document these "policies and practices" in the management plan.

**19. If these policies and practices are not presently covered in the management plan should we ask everybody to provide written documentation of the "policies" now or, do we wait until the management plan is renewed, or the next supervisory visit/compliance review (whichever comes first)?**

We recommend that you be sure borrowers understand that these issues should be addressed in their management plans and that you will review these items in your supervisory visits, compliance reviews and management plan approvals. However, the Agency is not required to conduct a full review of all existing management plans at this time.

**20. Attachment C also states that borrowers are supposed to maintain a record of the self-evaluation for at least three years. How are we going to document if they have one, if the three-year period is past?**

Part V of *Form RD 400-8, Compliance Review*, should contain a record of self-evaluation status based on Agency review. While the borrower is responsible to retain records for their own protection, we can retain any self-evaluation shared with us by the borrower in our files.



**21. Attachment C states that when structural changes are necessary, such changes shall be made within 3 years and as expeditiously as possible. What if major structural changes are needed and they can't be accomplished within a 3-year period?**

Realistically, all structural changes should be accomplished within a three-year time frame unless funding is an issue. When changes are not made within the time frame of the transition plan, the borrower should prepare a new or revised 3-year transition plan that documents what has been done, what will be completed, and time frames for completion. Before we accept a plan, we need to be sure that the borrower is sincerely attempting to comply with the accessibility requirements. We also need to assure that rents and reserve account (RA) withdrawals are approved when necessary to make the changes.

**22. Should transition plans exceed 3 years? We have seen some that just say “when funds are available.” These plans are typically in projects where there is very little or no RA and rents must be kept low to keep tenants. In these cases, there may never be funds available.**

Transition plans may not exceed a 3-year period and “when funds are available” is never a good time-frame. “Upon rehabilitation” is better language to use. If a poor rental market is the real issue, the transition plan should be clear that the market is the reason the borrower can not make needed improvements. If there is some way of addressing the cash flow problem (i.e., transfer RA, seek state or local grants, etc.), then the Agency should be ready to help the borrower move in that direction. This means that if a rent increase is needed, either to fund the improvement or build up the RA, the transition plan should document the amount that is needed and the Agency should be willing to approve higher rents. Also, the borrower should document their efforts to check for funding elsewhere. Some state and local governments have grant or loan funds that can be used for providing accessibility. Borrowers should be encouraged to seek out such funds if available. Once the 3 year period is completed, if corrections have not been completed, a new or revised transition plan would be required listing those incomplete items, with a proposed timeframe.

**23. Attachment C-2 has six additional items we are to review during the compliance review. Where are these items to be documented?**

You will notice that some of the answers are addressed by questions already on the physical inspection form or the compliance review. While, the Civil Rights Staff has not established a separate document for the purpose of documenting this review, your assessment of the borrowers response to the six items should be documented in part V or VI of *Form RD 400-8*.

**24. If we should find a borrower out of compliance with accessibility requirements and the borrower comes back with a transition plan that says they will make accommodations as needed, will the Agency be able to accept that and say that the borrower is now in compliance for tracking purposes?**

Yes, however the borrower is technically out of compliance until the problem is corrected. However, if the borrower has a self-evaluation and a transition plan that describes how that

particular finding will be resolved, we have established that the borrower is taking the appropriate steps to resolve their problem by establishing a timetable for corrective action in the transition plan. A good analogy is how we use our workout plan. If a workout plan is in place and being followed, the Agency can recognize that the default finding is being resolved. Therefore, we treat the project differently in our classification system.

**25. Could you give us an example where time frames for compliance will be provided in Agency notices and will vary according to the nature of the non-compliance issue.**

For example, according to Civil Rights Staff policy, findings on the compliance review should be corrected in 30 days. This timeframe may be expanded if conditions warrant. According to MFH program direction, supervisory visit findings can be resolved using different timeframes, generally varying from 30 to 90 days. The Servicing Office has some flexibility in providing corrective deadlines for findings found on the supervisory visit. Usually these deadlines are established in relationship to the seriousness of the finding. Additionally, the letter to the borrower requesting corrective actions can combine findings and corrective time frames from both the compliance review and the supervisory visit.

**26. Do you see any problem with the Agency keeping a copy of the self-evaluation and transition plan in the borrower's file? We initially told our field staff not to keep a copy because we didn't want the borrower to construe that as Agency approval of the documents; however, some of our field employees have asked for copies and are keeping them in the file.**

It is a good idea to keep the self-evaluations and transition plans in the file because you should be reviewing them with each management plan and budget approval. Routine budget approvals should now include reviewing the transition plan to make sure that identified capital improvements are in the budget.

**27. Are Agency field staff required to become “accessibility” police?**

It is important to understand that since June 10, 1982, 7 CFR 15b requires the Agency to conduct compliance reviews regarding accessibility requirements. The bottom line is that the borrower is the party responsible for project compliance with accessibility laws. The Agency's role is to assure that the program, in general, is administered in accordance with accessibility laws. We identify non-compliance during limited reviews, make project resources available to help solve problems, report problems through an internal reporting process, and respond to continued serious instances of non-compliance using established MFH program servicing tools.

**28. UFAS requires that wall cabinets in accessible units be mounted at 48" above the floor. In rehabs, that has required relocating them. One owner requested mounting a separate shelf 48" above the floor, between the base and wall cabinets. Is this OK?**

The Access Board has indicated that a shelf between base cabinets provides “equivalent” accessibility when it is not possible to lower wall cabinets. The shelf should not become the standard solution, but can be considered on a case-by-case basis. For example, if funds for

rehabilitation are limited, the shelf may be a less expensive solution to removing and relocating wall cabinets. If funds are available, the wall cabinets should be relocated. Although deemed “equivalent,” the shelf does not have doors to cover the storage space and should not be used if relocating wall cabinets is possible.

**29. Is a 30" x 34" high workspace required in an accessible dwelling unit kitchen? While UFAS 4.34.6.4 requires this, it is not included in the list in Attachment B or added to the MFH Physical Inspection Form.**

Yes, it's required. The list in Attachment B was not intended to be all inclusive of UFAS standards, but to hit the big issues.

**30. UFAS 4.13.9 calls for lever handles on entrance doors to accessible units. An item on the MFH Physical Inspection form asks if lever handles were provided. Does this apply to all apartment doors?**

UFAS requires lever handles on apartment unit entry doors only. The question on the MFH Physical Inspection form refers to apartment unit entry doors only. If a tenant needs lever handles throughout a unit, they may be requested as a “reasonable accommodation.”

**31. Where are grab bars required?**

Grab bars are required in the 5 percent of units that are “fully accessible.” UFAS 4.34.5 uses the language “If provided, grab bars will ....” Our Agency has taken the position that grab bars will be installed in order to make the “fully accessible” unit ready for a person with disabilities. Grab bars are also provided in those units in which a tenant has requested them as a “reasonable accommodation.” In those ground floor units constructed since 1991, FHA/AG required blocking for “adaptability.” In those units, grab bars may be installed later as a form of “reasonable accommodation” when requested.

**32. How do people writing Transition Plans know to require grab bars?**

Since writers of Transition Plans base them on UFAS, the proposed plan may call for installing the blocking only, and not installing the grab bars. In requiring a Self Evaluation and possibly a Transition Plan from a borrower, field staff should make them aware that the Agency has taken the position that grab bars are required in 5 percent of the units that are “fully accessible.”

**33. An item on the MFH Physical Inspection form refers to a “functional emergency call system.” Are emergency call systems required in all fully accessible units?**

If the fully accessible unit presently has an emergency call system, it must be functional. If no emergency call system is in place, the borrower does not have to provide one at this time. It may be necessary to add one as a “reasonable accommodation” per tenant request. There has been considerable confusion on this issue, and we realize that this may be a different answer than you have received in the past.

**34. Is additional maneuvering room in the bathroom required?**

Some Transition Plans are indicating a need to enlarge the bathroom in an accessible unit to provide a 5' turning circle, which UFAS requires in a common use bathroom. Writers of Transition Plans are incorrectly applying this requirement to a dwelling unit. Agency staff should understand that an accessible dwelling unit bathroom must have clear floor space at the tub/shower and commode, but a 5' turning circle is not required within a dwelling unit bath. Also, UFAS provides an exception in 4.22.3 for public toilets with only one lavatory and commode. In those common use toilets, a 5' turning circle is not required.

**35. In addition to the requirement that 5 percent of a project's units must be fully accessible for persons with mobility impairments, is it true that MFH projects must also meet a requirement that an additional 2 percent of the units (over and above the 5 percent) must be made fully accessible by individuals with hearing or visual impairments?**

To implement Section 504, both HUD and USDA individually published regulations to apply to their respective programs. While HUD's regulation does require that 2 percent of the units (over and above the 5 percent that are made fully accessible for persons with mobility impairments) be made accessible for individuals with hearing or visual impairments, USDA's regulation does not. Consequently, MFH projects with project based HUD Section 8 that were built on or after July 11, 1988, must meet this requirement, but MFH projects without project based HUD Section 8 do not. However, even when not required, borrowers are encouraged to make an additional 2 percent of the units accessible for persons with hearing or visual impairments.

**36. We have an existing MFH property with multiple laundry rooms. Must each laundry room be made accessible?**

Not necessarily.

- For a property constructed for first occupancy after March 13, 1991 and subject to the Fair Housing Amendments Act design requirements, laundries for the covered units must be on an accessible route, and the space must be accessible. This would apply to all ground floor laundries (or all laundries in a building with an elevator).
- In addition, for properties constructed, or with substantial alterations, after June 10, 1982, UFAS also applies. UFAS 4.1.3(3) states "Common Areas: At least one of each type of common area and amenity in each project shall be accessible and shall be located on an accessible route to any accessible dwelling unit." This sets a minimum of one accessible laundry. If accessible units are located near one another, the nearest laundry must be made accessible. If accessible units are located on opposite ends of the property, it may be necessary to make more than one laundry room accessible, depending on location and site topography. In such a situation, the nearest laundry room to each accessible unit must be made accessible.
- Regardless of when a property was constructed, it is the policy of RHS that, to the extent possible, barriers to common use areas that prevent any mobility impaired person from having

full access will be removed. This does not, however, require borrowers to exceed the above standards unless it is necessary to do so in response to a request for a reasonable accommodation from a person with disabilities.

In addition, UFAS 4.34.7.2 states that washing machines and clothes dryers in common use laundry rooms shall be front loading.” RHS has taken the position that this requirement is met if at least one washer and one dryer is front loading in every laundry room that is required to be accessible by UFAS. This position is taken, in part, in recognition that there may be some increase in cost to provide front loading washers and dryers.

**37. If structural accessibility requirements of the Fair Housing Act were not met due to negligence of the borrower or their architect during construction, what can be done to get them corrected?**

In cases where fault is established, it is a proper servicing action to seek corrections by borrowers at their own expense. To accomplish these corrections, some borrowers may in turn seek to enforce contractual agreements with project architects.

**38. When a MFH tenant requests a reasonable accommodation, my understanding is that project management should answer the following questions: whether the tenant household contains a qualified individual with a disability; whether the requested accommodation is related to the disability; and whether the requested accommodation is reasonable. If all these conditions are met, should project management automatically make a \$400 adjustment to income?**

Not automatically, but project management should examine the tenant household’s situation to see if any of the adjusted income reporting threshold changes required by 7 CFR 3560.152(e) will be met, especially a household’s potential change in status from non-elderly to elderly. There is no requirement that prevents a borrower from making a reasonable accommodation without receiving verification from the tenant that a household member meets the definition in 7 CFR 3560.11 of an individual with a handicap or disability. However, for a household to be considered elderly, the tenant or co-tenant must be the person with a verified handicap or disability, rather than a household member who is not the tenant or co-tenant. Consequently, there may be some instances where a tenant chooses not to apply or is ineligible for an elderly household status. Finally, we recommend that application forms ask questions in a direct manner, making the benefit of an elderly designation known, and then leaving it up to the applicant to request the designation (see question #9 of this attachment).

**39. What are the requirements for accessibility for a community room kitchen / kitchenette?**

In many situations, the requirements for an accessible dwelling unit kitchen have been applied to a common use kitchen or kitchenette. The Fair Housing Act Accessibility Guidelines and UFAS have similar requirements.

- The community room must be accessible, including an accessible route, accessible doors, switches and outlets at proper height, etc.
- The kitchen area must have an accessible sink per UFAS 4.24. This includes a mounting height no higher than 34" (or adjustable to 34"), knee clearance underneath, clear floor space at the sink, insulated piping, and an accessible faucet.
- UFAS 4.25 and 4.1.2(11) further requires that a portion of the storage provided (shelves, drawers, and cabinets) have clear floor space and be within the reach range. This requirement is normally met with standard kitchen base cabinets.
- The kitchen must have a 60" turning circle or "T" turn around for maneuverability. Space in the community room or a hallway immediately outside the kitchen may be used to meet this requirement.
- There is no requirement in a common use kitchen for an accessible work surface, range or cooktop with accessible controls, self cleaning wall oven, or an accessible refrigerator (side by side or with 50% of freezer space within reach ranges). These requirements appear in UFAS 4.34, and only apply to an accessible dwelling unit.

These requirements for a common use kitchen or kitchenette are minimums. Provision of additional accessibility in a common use kitchen or kitchenette is encouraged, but not required.

**40. Can the street be utilized as part of the accessible route to an amenity? Can the disabled travel behind parked vehicles or with the traffic in the travel lane?**

The accessible route may include travel behind a parked vehicle only if it is an accessible parking space. Crossing a traffic lane between curb cuts is acceptable. A striped crosswalk is not required (see question #13). Otherwise, the street or traffic lane may not be part of the accessible route for an individual using a wheelchair.

If the site amenity is located at a considerable distance from the accessible unit and its accessible parking space or if site terrain is such that an accessible route along sidewalks is not possible, a vehicle can be used. This requires an accessible parking space at the site amenity, with an accessible route from that parking space to the site amenity. In this situation, the disabled individual must travel from their unit to their accessible parking space, transfer to their vehicle, drive to the site amenity, transfer back to their wheelchair, and then go to the site amenity. As you can see, this is not a convenient solution, and should be used only on existing properties in cases where no other solution is possible.

## CHAPTER 4: FINANCIAL MANAGEMENT

### 4.1 INTRODUCTION

Successful projects require sound financial management procedures to track funds, prepare realistic budgets, manage project funds effectively, and report financial progress. This chapter covers the borrower's financial management responsibilities and provides guidance to Loan Servicers on monitoring a borrower's financial management performance.

The chapter is divided into five sections. Section 1 describes program requirements and Agency monitoring responsibilities for the project accounting system. Section 2 discusses the contribution, use, and monitoring of Initial Operating Capital. Section 3 outlines the requirements for and monitoring of reserve accounts. Section 4 explains project budget requirements and the budget approval process. Section 5 describes project reporting and financial examinations and Agency review of these reports.

### SECTION 1: PROJECT ACCOUNTING SYSTEM

#### 4.2 OVERVIEW OF ACCOUNTING SYSTEM REQUIREMENTS [7 CFR 3560.302]

Borrowers must establish accounting systems that support safe and sound project financial management. The accounting system must allow borrowers to track the use of funds, report accurate operational results to the Agency, and otherwise comply with the terms of their loan agreement. The following requirements apply to the borrower's accounting system:

- **Agency approval.** The accounting system must be approved by the Agency as part of the management plan (as discussed in Chapter 3). The borrower must notify the Agency of any changes in the method or system of accounting through a revision to the project management plan.
- **Method of accounting.** The borrower may use a cash, accrual, or modified accrual method of accounting, as long as the method is consistent with the statements required by the engagement in accordance with Paragraph 4.30.
- **Recordkeeping.** Borrowers must retain all financial records and supporting material for at least 3 years after the issuance of annual financial reports and financial statements. These records must be maintained in a manner that can be audited by the Agency or a third party. The Agency may request that these materials be made available if needed to examine the project's finances.
- **Account requirements.** The following general requirements apply to the borrower's accounts:
  - ◊ Accounts must be in domestic institutions;

- ◇ Accounts must be insured by an agency of the Federal Government, backed by collateral proved by the bank, or held in securities meeting the requirements of 7 CFR part 3560, subpart G; and
- ◇ Borrowers must maintain at least one demand deposit or checking account (so that funds are always readily available to pay necessary operating expenses).
- **Use of funds.** Funds must be held in trust by the borrower until used and serve as security for the Agency grant or loan (except for funds in the security deposit/membership fee or patron capital accounts).
  - ◇ In no case may project funds be pledged as collateral for nonproject debts; and
  - ◇ Funds must be used only for authorized purposes as described in 7 CFR part 3560, subpart G and the project loan agreement or resolution.
- **Separate accountability.** The accounting system must establish separate accountability for different projects. In other words, the borrower may combine funds from different projects owned by the same borrower with the same tax identification number or Social Security Number in the same bank account, as long as the accounting system segregates and tracks each project's funds separately. The management plan must document how revenue and expenses that are not clearly associated with a particular project are prorated across projects. (For example, the plan must document how costs for a computer system that serves several projects are allocated across the projects.) The accounting system must track these prorated costs.

### 4.3 OVERVIEW OF ACCOUNTS

The borrowers must establish and maintain the accounts required by their loan agreement or resolution. At a minimum, these include the following accounts:

- General operating account;
- Tax and insurance account (if the amounts escrowed are not part of the general operating account);
- Reserve account;
- Security deposit or membership fee account (if applicable); and
- For cooperative projects, a patron capital account.

Each account serves a different purpose, as described in the following paragraphs.

#### A. General Operating Account

The borrower must establish a general operating account to handle all revenues and expenses associated with project operations. Authorized expenses payable from this



account include expenses that are directly attributable to project operations and are necessary to carry out successful project operations. For a full list of acceptable expenses, see **Attachment 4-A**.

In addition, the borrower is required to deposit in the general operating account a minimum of 2 percent of the total project development costs. These funds must be deposited at loan closing or start of construction (whichever occurs first). This Initial Operating Capital is to be used for initial operating expenses, such as advertising, insurance, fidelity coverage, and initial lease-up expenses. The funds may also be used to meet project obligations, such as debt payments and reserve deposits, until cash flow is sufficient to fund these accounts.

Between the project's second and seventh year, borrowers may request that these funds be returned if the project is showing sufficient cash flow to cover all obligations, including funding the reserves. Withdrawals may be made in a lump sum or in annual increments between the second and seventh year. More detail on Initial Operating Capital is provided in Section 2 of this chapter.

The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, the calculation should include the amount that should be escrowed by year end and should subtract taxes and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

If the general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit into the in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year.

## **B. Tax and Insurance Account**

The borrower must deposit money, on a monthly basis, to pay required taxes and insurance. Generally, these funds can be kept in the general operating account, as long as they are tracked separately from other general operating funds to ensure that funds are available to pay taxes and insurance. In some cases, however, the Agency may require a separate account for taxes and insurance to ensure the availability of these funds. See Chapter 3 for a discussion of insurance requirements and taxes.

## **C. Reserve Account**

The reserve account is funded through contributions from project operating funds. It is used primarily to pay for large planned expenses for maintenance and improvements of capital items. The project's reserves must be held in a supervised account that requires the Agency's countersignature on all withdrawals. The administration of project reserves is covered in detail in Section 3 of this chapter.

## D. Security Deposit or Membership Fee Account

The security deposit or membership fee account holds funds provided by residents as security deposits and membership fees. See Chapter 7 for a full discussion of security deposits and membership fees.

- **Uses of funds.** Funds deposited in the security deposit/membership fee account must be used for purposes outlined in the management plan:
  - ◊ The borrower may only use security deposits to cover costs of fixing damage to unit beyond ordinary wear and tear by the tenant who provided the deposit. The funds must be returned to the tenant if not used. If the borrower cannot locate tenant to return the deposit, these funds must be deposited in the general operating account or handled in accordance with applicable state laws. In cooperatives, the return of membership fees depends upon the legal instruments governing the project.
  - ◊ Funds retained by the borrower as a result of a lease or occupancy violation must be transferred to the general operating account and treated as project income.
- **Interest.** The interest on security deposit/membership fee accounts is handled in accordance with state law. If no state law governs the use of interest, it must be deposited in the general operating account, at least once annually, and used for general operating expenses. In no case may interest accrue to the benefit of the borrower or management agent.

## E. Patron Capital Account

In cooperative projects, borrowers must establish a patron capital account to hold excess operating funds in trust for cooperative members.

- Any funds in excess of 3 months of average operating expenses remaining in the general operating account at the end of the fiscal year must be deposited in the patron capital account. This account must be interest bearing and must be administrated according to state laws governing patronage capital.
- Each member of the cooperative must be assigned an equal portion of the funds in this account. These funds are held in trust for the members of the cooperative until they terminate their membership in the cooperative. Members may receive their portion of the funds only if they have paid all membership charges and costs due the cooperative.

## 4.4 MONITORING THE ACCOUNTING SYSTEM

Loan Servicers must monitor project accounting systems to ensure that proper accounts are established and that these accounts are maintained in accordance with program requirements and the project's loan agreement/resolution.

The six specific circumstances when Loan Servicers must review a project's accounting system and project accounts are discussed below.

### **A. Review of the Management Plan**

When examining a borrower's management plan for a project, Loan Servicers must review the description of the accounting system to ensure that it addresses the requirements listed in Paragraph 4.2. In particular, Loan Servicers must ensure that:

- The system ensures separate accountability—it allows for separate tracking of funds for different projects owned by the same entity; and
- The system handles interest correctly and in a manner consistent with state law.

For a full discussion of the review of the management plan, refer to Chapter 3.

### **B. Pre-Occupancy Meeting**

The pre-occupancy meeting is held before the project begins the lease-up process. It represents a chance for the Loan Servicer to explain program requirements, including accounting requirements, to the borrower. In particular, the Loan Servicer should describe the accounts that must be established, acceptable accounting methods and institutions, and the need for separate accountability. If the borrower has already established the accounts, the Loan Servicer should examine statements from the financial institution to ensure that all appropriate accounts were established. (For a full discussion of the pre-occupancy meeting, see Chapter 8 of HB-1-3560.)

### **C. Post-Occupancy Visit**

As part of the post-occupancy visit, the Loan Servicer must confirm that the borrower has established the appropriate accounts and is making the required deposits. The Loan Servicer must examine the borrower's bank statements to ensure that accounts were established and that they were established in a proper institution with proper insurance. The procedures for this visit are described in Chapter 8 of HB-1-3560.

### **D. Quarterly and Monthly Reports**

Quarterly and monthly reports provide an opportunity to check on the status of project accounts of new and troubled projects on a regular basis. The Agency does not expressly require submission of these reports except from projects during their first 12 months of operation or from troubled projects. When reviewing these reports, Loan Servicers must verify account information and take the following actions:

- Confirm that the account balances provided on the reports are appropriate. For example:
  - ◊ Are the reserves reported at the appropriate level as specified in the loan agreement/resolution?
  - ◊ Does the balance in the security deposit/membership account appear appropriate for the number of tenants and the amount required for deposits/fees?
  - ◊ Does the tax and insurance escrow reflect appropriate monthly deposits and appropriate withdrawals? (Taxes may be due monthly, quarterly, biannually, or annually.)
  - ◊ Have there been any dramatic, unexplained changes in the general operating account?
- Confirm that the funds are deposited in accounts that are backed by either of the following:
  - ◊ Federal Deposit Insurance Corporation (FDIC) insurance coverage;
  - ◊ Collateral pledges of amounts above FDIC limits; or
  - ◊ Other coverage against theft or dishonesty.

## **E. Budget Review**

During the review of the budget, Loan Servicers must evaluate the borrower's plans for funding, maintaining, and using the accounts to determine if the budget is realistic and reasonable. See Paragraph 4.18 for more information.

## **F. Annual Financial Reports**

The review of the annual financial reports provides the most detailed information on the status of project accounts. The annual financial report looks specifically at the accounting system to confirm that the required accounts are properly maintained and tracked separately. The annual financial report also looks at each account to make sure that deposits and withdrawals comply with programs rules—that funds were expended for proper purposes and all required payments and deposits were made. In reviewing the annual financial report, the Loan Servicer is able to obtain information about the financial stability of the project. If the report indicates that there is a negative trend in the project's finance, this alerts the Loan Servicer to review project operations more closely.

## **SECTION 2: INITIAL OPERATING CAPITAL AND BORROWER RETURN ON INVESTMENT [7 CFR 3560.304 and 7 CFR 3560.305]**

### **4.5 INTRODUCTION**

This section is about a fund, known as Initial Operating Capital, which the Agency requires to protect the security of the project during its initial years.

### **4.6 PURPOSE**

The period between initial occupancy and full rent-up in a project can be risky because rental income may not be sufficient to cover all operating costs, make payments on the Agency loan, and make required contributions to the reserve fund. In addition to these regular operating expenses, there are some special expenses associated with this period, such as purchasing furniture or equipment for public spaces or advertising and marketing. To assist projects through this phase, the Agency requires the establishment of a fund for Initial Operating Capital.

### **4.7 CAPITALIZATION OF INITIAL OPERATING CAPITAL**

All borrowers must provide Initial Operating Capital equal to at least 2 percent of the loan amount to support initial operation of the project. Limited-profit borrowers must put this amount down at the loan closing or construction start, whichever comes first. The Agency may loan the required 2 percent to not-for-profit borrowers. (For details on this process, see HB-1-3560.) Borrowers provide the Agency with a list of proposed uses for Initial Operating Capital during loan origination.

### **4.8 ACCOUNTING FOR INITIAL OPERATING CAPITAL AND OTHER ADVANCES**

#### **A. Initial Operating Capital**

When the project accounts are established, Initial Operating Capital is blended with other revenue and used for operating expenses.

The borrower may leave an amount of money equal to the initial capitalization of the fund in the operating account. This money should not be treated as excess funds in the operating account nor should it be transferred to reserves. In addition, its presence in the operating account should not be used as justification to deny a rent increase.

#### **B. Other Borrower Advances**

Prior written approval by the Loan Servicer is required for any advances made by the borrower, borrower entity, or designee to cover ordinary project operating expenses. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short term in nature, a servicing plan may be developed and advances may be approved if justified by the following:

- A review of the documented circumstances and the project operating budget before any funds are advanced. The financial position of the project must not be jeopardized.
- Funds are not immediately available from any of the following sources:
  - ◊ Reserve funds;
  - ◊ Initial operating capital; or
  - ◊ An imminent rent increase.

Interest may be charged or paid on the loan from project income; however, interest must be reasonable. The proposal may be denied if Agency financing can be provided to resolve the problem in a more cost-effective manner.

No lien in connection with the loan will be filed against the property securing the Agency's loan or against project income. The advance may show as an unsecured project liability on financial statements prepared for year-end reports until such time as it is authorized to be repaid.

#### **4.9 DURATION OF INITIAL OCCUPANCY**

The initial occupancy phase lasts until the project has attained a stable occupancy rate and the operating budget can reliably be supported by rental income. Projects vary as to when they achieve this stability; the Agency anticipates its occurring sometime between the end of the second and seventh year of occupancy. At that point, a for-profit borrower whose cash contribution created the Initial Operating Capital may request that the contribution be repaid.

#### **4.10 REPAYMENT**

##### **A. Agency Policy**

The borrower may, with the consent of the Agency, withdraw its original contribution to the Initial Operating Capital in multiple annual installments or a single installment between the second and seventh full year of project operation, provided the borrower can satisfy Agency criteria for approving repayment. Repayment can only be made once the project has been operating for 2 years and the project's operations and finances have stabilized. Repayment must be made during the initial operating phase, which ends at the close of year seven. Repayments may be in one to five installments, until the borrower's contribution to Initial Operating Capital has been fully repaid. The financial condition of the project may preclude full repayment of Initial Operating Capital.

The borrower must be able to demonstrate that the project is financially stable, that repayment will not require a rent increase, and that the project is in compliance with Agency requirements.

## B. Borrower Submissions

- The borrower may submit a request for repayment of Initial Operating Capital with the transmission of the annual financial report.
- The borrower's request is submitted in writing and addressed to the Servicing Office.
- The submission includes documentation demonstrating how the project meets Agency criteria for repayment:
  - ◇ The project's financial position is stable;
  - ◇ The project has averaged 90 percent occupancy over the most recent 12 months;
  - ◇ Contributions to reserves are on schedule;
  - ◇ There are no outstanding compliance violations;
  - ◇ The project is not under a workout agreement; and
  - ◇ Repayment will not require a rent increase.
- The submission should specify the amount of the repayment the borrower is requesting in the current year, and, if applicable, the borrower's plan for completing repayments in ensuing years.

## C. Agency Processing

Staff examine the submission for eligibility, completeness, and compliance with the criteria the Agency has established that a project must meet in order for a repayment to be made. If staff find that the project can support the repayment, an additional analysis is performed to compute the amount.

Staff may approve requests for the repayment of Initial Operating Capital only if the borrower's written request and the Agency's records demonstrate the following criteria:

- **Occupancy.** The occupancy rate for the project over the most recent 12 months has averaged 90 percent.
- **Contributions to reserves.** Contributions to reserves are on schedule, less any authorized withdrawals.
- **Sufficient income.** When the amount of the repayment is subtracted from the general operating account the ending cash balance still includes an amount equal to 10 percent of projected annual operating costs, and all required payments for taxes and insurance.

- **Impact on rents:**

- ◇ Repayment is denied if it creates a shortfall in operating income that must be made up by a rent increase.
- ◇ There is no issue if no rent increases are projected in the year the repayment is made.
- ◇ A rent increase will not affect repayment if rents are increasing to cover increases in costs, such as wages, taxes, or insurance.

### ***1. Amount of Repayment***

The borrower may receive an amount equal to the original contribution of Initial Operating Capital or a smaller installment if the operating budget cannot support repayment in a single installment (see examples).

<b>Example</b>			
	Case One	Case Two	Case Three
Year-end cash balance	\$57,000	\$40,000	\$27,000
10% O&M requirement plus taxes and insurance	27,000	27,000	27,000
Initial Operating Capital	30,000	30,000	20,000
<b>Repayment Amount</b>	30,000	13,000	30,000
Initial Operating Capital unpaid balance	0	17,000	30,000
The borrower in Case One can be repaid in a single installment. The borrower in Case Two would require three installments, assuming little change in the project's financial condition. The borrower in Case Three could not receive any repayment this year.			

### ***2. The Decision Process***

- The Servicing Office has 60 calendar days to review the annual financial statement, including the request for repayment of Initial Operating Capital.
- The Servicing Office may decide to:
  - ◇ Permit repayment in the amount requested by the borrower;
  - ◇ Permit repayment, but in an amount less than that requested by the borrower; or
  - ◇ Refuse repayment because the project does not meet the criteria for repayment.
- The decision of the Servicing Office is transmitted in a letter to the borrower. In addition to the amount, if any, of the authorized repayment, and/or the reasons for denying repayment, the letter states the amount of any remaining unpaid balance of the original contribution to Initial Operating Capital.



- Multi-Family Information System (MFIS) is updated to show the amount of the authorized repayment and the unpaid balance of Initial Operating Capital.

#### **D. Repayment of Advanced Loan Funds**

The payback of the advance may be permitted by the Loan Servicer, provided the terms and conditions were mutually agreed to by the borrower and the Agency at the time of the advance and the financial position of the project will not be jeopardized. Payback should only be permitted on the advance when the Agency debt is current and the reserve requirements are being maintained in accordance with Section 3.

#### **4.11 RETURN ON INVESTMENT**

The borrower may take the return on investment (ROI) before withdrawing the original contribution to Initial Operating Capital. Borrowers may receive a ROI in accordance with the terms of their loan agreement and the following:

- The borrower may take the ROI after the project's fiscal year ends if there is a positive net cash flow and the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that the borrower should not have taken an ROI, the Agency will require the borrower to return the unauthorized ROI to the project.
  - ◇ The Agency considers excess cash to be the portion of the ending cash balance on *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* that exceeds 20 percent of annual operating and maintenance expenses, the taxes and insurance escrow, and 2 percent money, if applicable.
  - ◇ When determining positive net cash flow, the Agency will consider such items as accounts payable and reserve withdrawals to cover operating expenses. For example, the borrower may not circumvent the order for funding accounts by using reserve funds or creating an accounts payable for budgeted operating expenses to make it appear as though the budget has a positive cash flow at year-end.
- Since the Agency permits the current year's ROI to be taken from excess project funds at the end of the following fiscal year, the Agency will, in turn, permit the current year's ROI to be taken from excess project funds at the end of the current fiscal year. The borrower is not to use the same ROI-approval criteria as that which allows for excess project funds to be used as long as it does not result in a rent increase and the reserve account is current less authorized withdrawals. Under these conditions, the borrower must receive specific authorization from the Agency. Under all conditions, the borrower may not take an ROI from project funds until after the end of the project's current fiscal year.

- If the project's operations show a negative cash flow, the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the project's annual financial report and determines:
  - ◊ There is surplus cash in either the general operating account or the reserve account; and
  - ◊ The housing project has sufficient funds to address identified capital or operational needs.
- The borrower may take the ROI from the reserve account if the conditions set out in the loan agreement are met.

<b>Example</b>
<p><b>Case One:</b> Consider a project that has been operational for eight years, has a \$1,000 ROI specified in the loan agreement, and needs \$10,000 excess cash to cover 10 percent of annual operating and maintenance expenses and taxes and insurance escrow.</p> <p style="padding-left: 40px;">If the project had a negative cash flow after payment of operating and maintenance expenses, reserves, and debt service expenses during the calendar year (CY) 2003 but had \$20,000 available in the general operating account, the Agency would approve an ROI from funds available at the end of CY 2003.</p> <p style="padding-left: 40px;">If the project had a negative cash flow during CY 2003 but had only \$5,000 available in the general operating account, the Agency would not approve an ROI from funds available at the end of CY 2003</p> <p><b>Case Two:</b> Consider the same project as described in Case One. During CY 2003, the borrower believed that there would not be adequate cash to pay taxes at year end, so the borrower requested \$2,000 from the reserve account for operating purposes; however, the project ended the year with \$3,000. In this case, the borrower can take the \$1,000 without Agency permission. However, if the net cash amount was less than \$2,000, the borrower can only take ROI from excess cash.</p>

## **SECTION 3: REPLACEMENT RESERVES [7 CFR 3560.306]**

### **4.12 PURPOSE OF RESERVES**

The Agency has a financial interest in a project over the life of its loan. During this period, which can be as long as 50 years, major replacements and capital expenditures will have to be made to the building, such as replacing the roof, rewiring, replacing windows, doing major exterior work, and adding new kitchen and bathroom fixtures. If these expenditures are not made, the property loses value, becomes less attractive to tenants, and begins to deteriorate, and the Agency's financial interest is at risk.

In most cases, such expenditures cannot be met out of annual operating income. Therefore, the Agency requires that a certain amount of rental income each month be deposited in a special, interest-bearing savings account—a reserve account—with rates greater than or equal to passbook savings or checking accounts. The Agency's expectation is that over time, the accumulation of funds in this account will be sufficient to meet these major capital costs. Adequate replacement reserves are a critical component of a successful project.

### **4.13 RESERVE ACCOUNT REQUIREMENTS**

The reserve account is a required account subject to the requirements set out in this paragraph. The borrower will initiate monthly deposits in this project account, preferably an interest-bearing account, starting the same month the first loan payment is due the Agency. As projects age, the required reserve account level may be adjusted to meet anticipated life-cycle needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

- All Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing borrowers operating projects (i.e., all Farm Labor Housing borrowers exclusive of On-Farm Labor Housing borrowers) with fewer than 12 units are required to establish a reserve account.
- Effective July 26, 1994, reserve funds were required to be placed in a supervised account. The provisions of 7 CFR part 1902, subpart A, apply. Reserve funds on deposit prior to this date in instruments that are subject to monetary penalties for early withdrawal may be temporarily held for the time needed to avoid such penalties.

### **4.14 RESERVE INSTALLMENTS**

Immediately after paying each installment for the orderly retirement of the Agency loan as provided in the borrower's *Form RD 3560-52, Promissory Note* required reserve installments will be transferred to the Reserve Account at least at the required rate stipulated by the borrower's loan agreement or resolution starting with the date the first payment is due to the Agency. Transfers will continue until the account reaches the total amount specified in the loan agreement or resolution. Transfers will be resumed the period following withdrawals that

decrease the reserve account balance below its required level until it is restored to the specified total minimum sum.

#### **4.15 RESERVE ACCOUNT PRINCIPLES**

Reserve account funds are governed by the following principles:

##### **A. Primary Use**

The reserve account is primarily used to meet the major capital expense needs of a project. It is expected that the reserve account should rarely have to be used to meet any noncapital expense need of a project; however, the Loan Servicer may approve such uses when warranted in unusual circumstances (e.g., a cash income shortfall).

##### **B. Investment Vehicles and Institutions**

Reserve account funds not immediately needed to pay for expenses or authorized purposes may be held as set out in this paragraph. Reserve account funds may be held in the form of a checking, savings, negotiable order of withdrawal, or similar account at a Federally insured domestic institution, such as a bank, savings and loan, or credit union.

- Reserve account funds may be held in the form of readily marketable obligations of the U.S. Treasury Department (e.g., U.S. Treasury bonds, U.S. Savings bonds, zero coupon bonds, etc.) at a Federally insured domestic institution or at an insured domestic institution authorized to sell securities.
- Reserve account funds may also be held in the form of an account (the account may be a tax exempt account or a taxable account) established at an insured domestic institution authorized to sell securities (the institution may or may not charge brokerage fees), provided the accounts meet the remaining conditions set out in this paragraph and are not used in a speculative manner.

##### **C. Limitations on Investments in Securities**

Any securities must be backed by the U.S. Government or an Agency of the U.S. Government, or be triple A-rated Government National Mortgage Association collateralized tax-exempt bonds or be triple A-rated pre-refunded bonds. Pre-refunded bonds are bonds that originally may have been issued as general obligation or revenue bonds but are now secured, until the call date or maturity, by an escrow fund consisting entirely of direct Government obligations that are sufficient for paying the bondholders.

##### **D. Reporting Actual Costs of Securities**

To assure that required amounts have been paid into the reserve account, the actual costs of securities (which in many cases may not be the face value) must be shown on the project books. In addition, details of these transactions should be disclosed in footnotes to financial information provided to the Agency.

### ***1. Security Sales***

When the Agency approves withdrawals from the reserve account and the funds are invested in securities, borrowers must, to the extent that securities are available, assure that securities are sold in an amount that results in proceeds sufficient to cover the disbursement.

### ***2. Forecasting Security Sales***

Since the sale or redemption of any securities may result in cash proceeds of less than the amount invested, borrowers should take steps to minimize the risk of loss from converting securities to cash. Needed reserve account withdrawals should be forecasted well in advance to permit Agency approval of anticipated needs, such that security sales can be arranged to be sold in favorable market conditions. When sales of securities take place, the proceeds will normally be held in a reserve fund at a domestic bank, savings and loan, credit union, or similar institution insured by an Agency of the Federal Government until such time as withdrawals are actually needed for the purposes authorized. Should unusual circumstances require the sale of securities in unfavorable market conditions the borrower will not be required to reimburse the project for any losses incurred.

### ***3. Knowledge Required of Securities Investors***

Those investing in securities must be knowledgeable of common industry practices prior to investing in securities. Knowledge of the various fees that may be associated with the purchase and sale of securities and the maintenance of security accounts must be considered when making security investments (e.g., front-end loads or fees, back-end loads or fees, maintenance fees, etc.). Such fees may be paid by the general operating account or by the reserve account. However, the Agency must give its prior consent before reserve account funds may be used.

### ***4. Financial Advisor Limitations***

Project proceeds may not be permitted to be used to pay for the services of a financial advisor to assist in the selecting of securities for investments, since the securities permitted are relatively limited and must meet the requirements set out herein. However, normal brokerage fees may be paid to secure and sell securities. It is recognized that financial advice may also be provided as part of the normal brokerage fee.

## **4.16 EXCESS RESERVES**

Any amount in the reserve account that exceeds the total sum specified in the loan agreement or resolution may be transferred to the general operating account for the authorized purposes only when it is agreed between the borrower and the Agency to be in excess of the requirement and there is a specific need for the excess funds. However, the Loan Servicer may direct the excess sum to be retained in the reserve account or applied as an extra payment on the loan.

#### 4.17 RESERVE ACCOUNT USE

Funds in the reserve account may be used for purposes in accordance with this paragraph. The borrower will request withdrawal of reserve funds in a written or confirmed manner before they are needed. Annual budgets are to include realistic routine income and expense levels to avoid the need to use the reserve for routine expenses (operating shortfalls), not caused by emergencies or very unusual servicing situations; but when needed, use of reserve funds may be permitted with Agency approval.

Borrowers (except nonprofit borrowers) are entitled to receive 25 percent of the interest earned on the reserve account annually. This is not to be considered part of the ROI.

- The Loan Servicer will take prompt action on a request for reserve withdrawal (normally within 5 working days of the request) and provide written authorization to the borrower for any authorized withdrawal of funds by the use of *Form RD 3560-12, Request for Authorization to Withdraw Reserve Funds*, before the borrower actually withdraws any funds.
- Although the prior consent of the Government is required for the use of reserve funds, the Loan Servicer may post approve the use of reserve funds if they were used for authorized purposes and their expenditure would have been approved had a request for approval been submitted prior to the withdrawal. The borrower must provide documented evidence showing the actual amount and use of funds before the post-approval action. Authorized purposes include:
  - ◇ To pay cost of repairs or replacements to the housing, furnishings, or equipment or shortfalls of current expenses. Withdrawal for planned authorized purposes should be approved in advance during the annual budget approval process.
  - ◇ To make improvements to the housing project without creating new living units or to retrofit units to make them accessible to the physically handicapped.
  - ◇ For other purposes desired by the borrower, which in the judgment of the Government will promote the loan purposes; strengthen the security; or facilitate, improve, or maintain the project and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security. Reserve funds may also be used to facilitate payment of fees associated with the buying or selling of securities or maintaining a securities account.
  - ◇ To meet payments due on the loan obligations in the event the amount for debt service is not sufficient for that purpose.
  - ◇ To pay a ROI at the end of the borrower's project operating year, provided that after these disbursements the amount in the reserve account will not be less than that required by the loan agreement or resolution to be accumulated by that time (taking into consideration the provisions of any approved servicing plan which may be authorizing a temporary adjustment to these provisions), minus any

authorized withdrawals, and provided that the amount in the reserve account will likely not fall below that required to be accumulated during the next 12 months.

- ◆ In the case of borrowers' operating on a limited-profit basis, paying a return on the borrower's initial investment as identified in the loan agreement or resolution; and
- ◆ In the case of borrowers' operating on a full-profit basis, paying an annual return as specified in the borrowers' loan agreement or resolution.

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## SECTION 4: PROJECT BUDGETS

### 4.18 BUDGET REQUIREMENTS [7 CFR 3560.303]

Project budgets are planning documents that provide a picture of project financial operations. They reflect the project's expected revenues and expenses, including plans for maintenance, capital improvements, reserve account activity, and the owner's return for the coming year.

Borrowers must submit annual project budgets to the Agency for approval. Budgets must meet the following requirements:

- Budgets must be reasonable and realistic. Revenues and expenses must be consistent with past project budgets and comparable projects. Any differences must be due to legitimate operating needs of the project.
- Project expenses can include only expenses necessary to maintain successful projects. (An example of an unnecessary expense is owner or manager entertainment expenses.) Project expenses cannot be used for unearned personal benefit or gain, or for reimbursement of false or inaccurate expenses.
- The borrower must not include expenses for purposes unrelated to the housing project or for fines, penalties, and legal fees where the borrower has been found guilty of violating laws such as civil rights, evictions, and building codes.
- The borrower is responsible to submit project budgets that address the project's physical accessibility needs. The Loan Servicer may approve the cost of providing accessible rental housing as an authorized use of project funds.
- The borrower must not include organizational expenses among project expenses. These items are covered by the management fee. (For a list of items covered in the management fee, see **Attachment 3-C**.)
- Nonprofits and cooperatives may request a reasonable fee for borrower oversight functions such as:
  - ◊ Board of Director's review and approval of proposed budgets, including proposed repairs, outlays, and accruals;
  - ◊ Review of capital expenditures over \$500;
  - ◊ Approval of annual financial reports and considerations of any management comments noted; and
  - ◊ Long-term asset management reviews.

- The priority order of project expenditures must be:
  - ◊ Prior lien holder, if any;
  - ◊ Operating and maintenance expenses, including taxes and insurance;
  - ◊ Debt service to the Agency;
  - ◊ Reserve account deposits;
  - ◊ Other authorized expenses; and
  - ◊ Return on the owner's investment.

#### **4.19 SCHEDULE FOR BUDGET REVIEW AND APPROVAL**

The schedule for submitting budgets depends on whether the proposed budget includes a rent change. Budgets with rent increases require extra time for approval. Exhibit 4-1 outlines the schedule for budgets with and without rent increases.

##### **A. Agency Review Time**

The total Agency review time for a budget from submission to initial approval or rejection is:

- Thirty days for budgets without rent increases; and
- Sixty days for budgets with rent increases.

If the initial budget is rejected, this schedule allows for a second review of the budget and approval (if appropriate) before the start of the fiscal year.

##### **B. Late Budget Submissions**

The schedule provided for budget reviews relies on timely submission of budget documents by the borrower. If the borrower is tardy in submitting required documents, the Agency cannot ensure that all deadlines will be met. Therefore, if a borrower submits the budget late, Agency deadlines no longer apply, and the borrower is not eligible for “automatic approval” of the budget (as discussed in Paragraph 4.28 B). If no budget is approved by the end of the project's fiscal year, the borrower must operate under the previously approved budget until the Agency reviews and approves the new budget.

<b>Exhibit 4-1</b>	
<b>Schedule for Budget Submission and Review</b>	
<b>Budgets without Rent Increases</b>	
60 days prior to end of the project's fiscal year <i>November 1*</i>	Borrower submits budget documents to Agency. Agency has <u>30 days</u> total to review the complete budget ( <i>December 1 if budget was received on time</i> ).
30 days prior to end of fiscal year <i>December 1</i>	Agency approves or denies the budget.** <ul style="list-style-type: none"> <li>If the budget was denied, the borrower may submit additional information to address deficiencies within <u>10 days</u> (<i>December 11</i>).</li> <li>Agency makes final approval or rejection of budget within <u>20 days</u> of receipt of this information (<i>December 31</i>).</li> </ul>
End of fiscal year <i>December 31</i>	Final approval or rejection of the budget. If budget is rejected, the previous year's budget remains in effect.
<b>Budgets with Rent Increases</b>	
90 days prior to end of fiscal year <i>October 1*</i>	Borrower submits budget documents to Agency and notifies tenants of requested rent increase. <ul style="list-style-type: none"> <li>Tenants have <u>20-day</u> comment period to get back to the borrower (<i>October 5</i>).</li> <li>Agency has <u>45 days</u> total to review the budget (<i>November 15</i>).</li> </ul>
60 days prior to end of fiscal year <i>October 31</i>	Agency provides notice to the borrower of budget approval or denial.** <ul style="list-style-type: none"> <li>If the budget was denied, the borrower may submit additional information to address deficiencies within <u>10 days</u> (<i>November 10</i>).</li> <li>Agency has <u>20 days</u> to review the additional information (<i>November 30</i>).</li> </ul>
30 days prior to end of fiscal year <i>November 30</i>	Agency gives final approval or denial of the budget. <ul style="list-style-type: none"> <li>If the budget is approved, tenants must have <u>30 days'</u> notice before the rent increase takes effect. (If the notices given to tenants at the outset stated the amount of the effective increase, then notice has been given).</li> <li>If the rent increase is denied, the borrower may submit a revised budget at previously approved rents with expenditures acceptable to the Agency. In the absence of such a revised budget, the prior year's budget will go into effect.</li> </ul>
Beginning of project's fiscal year <i>January 1</i>	New budget and rent increase take effect.
<p>* The dates provided are for a sample project with a fiscal year that begins January 1. For projects with different fiscal years, adjust accordingly.</p> <p>** If the borrower submitted the budget on time, and has not been notified by the Agency of any deficiencies by this time, the budget is considered approved unless it is not eligible for automatic approval. (see Paragraph 4.28 B.)</p>	

### C. Steps in Budget Review and Approval Process

When reviewing and approving budgets, Loan Servicers must take the steps shown in Exhibit 4-2.

**Exhibit 4-2****Steps in the Budget Review and Approval Process**

- Follow procedure for receipt of budgets (Paragraph 4.20 B);
- Prioritize budgets for review (Paragraph 4.22);
- Review outstanding monitoring findings (Paragraph 4.23);
- Review the budget for reasonableness (Paragraph 4.24);
- Review the reserve account (Paragraph 4.25);
- Review the rent change, if requested (Paragraph 4.26); and
- Approve or deny the budget (Paragraph 4.28).

Budgets for projects that receive HUD Section 8 assistance need to be reviewed with the same rigor as other projects. However, there are certain procedures that differ; Paragraph 4.27 discusses these procedures.

**4.20 RECEIVING THE BUDGET**

Standard procedures for budget receipt will help Loan Servicers to track the progress of budgets through the approval process and meet approval deadlines. Further, intake procedures should help prioritize the review of budgets so that those with the highest priority (e.g., those with rent changes) receive the attention they need in a timely manner.

**A. Budget Submissions**

The borrower must submit a budget narrative, budget form (*Form RD 3560-7*), and capital budget form (or other form as approved by the Agency) as part of the budget submission.

**1. Budget Narrative**

The budget narrative provides a description of the budget and highlights important elements to aid Loan Servicers in their review of the budget. Items to be covered in the budget narrative are listed in Exhibit 4-3.

**Exhibit 4-3****Items to Be Covered in a Budget Narrative**

- A brief description of the project and its status. The description should address key indicators of project status. For example, it should highlight any issues concerning vacancies, unexpected maintenance, or other items that affect the budget.
- A statement of project compliance. This statement should indicate any outstanding monitoring findings and the borrower's progress in addressing these compliance problems.
- A description of the project's financial status, highlighting the project's overall financial status, important changes during the last year, and factors contributing to financial difficulties.
- An explanation of any changes in project expenses or cash sources that exceed the tolerance threshold.
- An explanation of projected capital expenditures and reserve withdrawals for the upcoming year and capital needs for the next three years beyond the budget year.
- If applicable, a statement that the proposed budget includes a rent increase and reasons for the increase.
- Any additional documentation necessary for the Agency to establish that applicable Agency requirements have been met.

**2. Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance**

This Agency form outlines the budget by line item and provides information on cash sources and uses, including rents and reserves.

**3. Capital Budget**

The capital budget form provides information on plans for capital improvements. It lists all the capital items in the project and provides space for the borrower to indicate their condition and any needed improvements.

**B. Procedure for Receiving Budgets**

The following steps are taken upon receipt of budget submissions:

- The Loan Servicer should date stamp them, enter them into MFIS, and forward them to the appropriate Servicing Official.
- When the borrower's notification of intention to request a rent increase is received, the Loan Servicer should establish a rent change folder for tenant comments.
- When tenant comments are received, the Loan Servicer should review, record, and file them.

The Loan Servicer may use the MFIS Report “Budget Approval Review” to assist with the steps outlined in Paragraphs 4.21 through 4.28.

## 4.21 BUDGET REVIEW

### A. Procedure for the Budget Review

The following items must be checked in the review:

- Verify that all required items in the budget narrative have been addressed (see Exhibit 4-3 for a listing).
- Review *Form RD 3560-7* to verify that all appropriate line items are completed. Perform a quick assessment to ensure that they appear to be completed properly.
- Verify that the capital budget is complete. Capital improvements needed to implement a borrower’s transition plan should be included as part of the capital budget portion of *Form RD 3560-7*, when applicable (for information regarding transition plans, see Paragraph 3.4). Compliance-related costs include reasonable fees and costs for preparing self-evaluations and transition plans.

If the budget is complete, the budget review should continue as described in the following sections. If the budget is incomplete, the Loan Servicer must take the steps described in Paragraph 4.21 B.

### B. Incomplete Budgets

If any items discussed in Paragraph 4.21 A are missing or are of such poor quality that there is insufficient information to begin an assessment of the budget, the budget is considered incomplete.

If the budget submission is incomplete, the Loan Servicer must contact the borrower, stating that the budget is incomplete, and discuss the deficiencies.

#### **Good Practice: Start a Review Right Away**

A budget that is missing a small amount of information can still be reviewed. Loan servicers should prioritize the budget for review as described in Paragraph 4.22 and begin to assess the budget, given the information provided.

- If the borrower does not submit the requested information within a 10-day time period from the Agency’s contact, the Agency cannot guarantee approval of the budget before the beginning of the new fiscal year. In these cases, the borrower must continue operations under the previous year’s budget until a budget is approved. The borrower is not eligible for automatic approval as described in Paragraph 4.28 B, and the budget will be returned unapproved.
- If the borrower does submit the information within 10 days, the budget is considered to be on time, and the review can still be completed prior to the end of the fiscal year. The budget is eligible for automatic approval, as described in Paragraph 4.28 B.

## **4.22 PRIORITIZING BUDGETS FOR REVIEW**

After budgets have been received and determined to be complete, the Loan Servicer should prioritize budgets for review. Prioritizing the budgets helps to ensure that the budgets that require the most thorough review receive the attention they need. Budgets with the highest priority for review include budgets for projects with:

- Requests for rent increases above \$25;
- Vacancy rates above the allowable threshold (see Paragraph 4.24 B for an explanation of this threshold); and
- Past monitoring findings.

While Loan Servicers should place the highest priority on reviewing these budgets, they should plan their time to allow for sufficient review of all budgets.

## **4.23 REVIEWING OUTSTANDING COMPLIANCE ISSUES**

Having determined that the budget submission is complete, the Loan Servicer must check the project for outstanding compliance findings and assess whether the borrower's budget narrative reflects adequate efforts to address these findings.

Specifically, the budget narrative must discuss the following issues and explain how they are addressed in the proposed budget.

- Any outstanding findings from last year's annual financial report;
- Outstanding findings from recent physical inspections or supervisory visits (to be renamed occupancy and management/administration reviews); and
- Workout agreement (if applicable).

If the outstanding monitoring issues have been adequately addressed in the budget narrative, the Loan Servicer should proceed with the review for reasonableness (see Paragraph 4.24). If project compliance issues have not been addressed, the budget documents should be returned to the borrower for revision.

## **4.24 REASONABLENESS REVIEW**

If all outstanding compliance issues have been addressed, the Loan Servicer must review the budget for reasonableness. The Loan Servicer must use the steps outlined in Exhibit 4-4 to make a determination of reasonableness.

### **A. Tolerance Threshold**

In reviewing the proposed budget, Loan Servicers must apply a tolerance threshold of 10 percent. This means that when Loan Servicers perform the reasonableness analysis, if specific budget items (as identified in Exhibit 4-4) differ from the appropriate benchmark

by more than 10 percent, they are considered to exceed the tolerance threshold and require additional analysis, as described in subparagraph D below.

### **B. Reasonable Vacancy Allowance**

A vacancy allowance is considered reasonable if it does not exceed the previous 3 years' historical vacancy and contingency allowance in the property, plus an additional 2 percent (to allow for unpredictable changes in vacancies). However, the vacancy rate is capped at the following levels:

- For projects with 15 or fewer units, the historical vacancy rate is capped at 15 percent (allowing for a total vacancy rate of 12 percent).
- For projects with more than 15 units, the historical vacancy rate is capped at 10 percent (allowing for a total vacancy rate of 17 percent).
- In unusual circumstances when vacancy rates exceed caps, a workout plan must be submitted prior to receiving budget approval.

### **C. Utility Allowance Analysis**

Depending upon the rate of change in costs, the borrower must provide the following documentation describing the utility allowances:

- If utility costs have changed significantly (over 15 percent):
  - ◊ Documentation of the extent of the utility rate changes. This may include billing information or documentation from utility companies; and
  - ◊ A significant sampling of tenant utility usage from the utility company. If tenant utility information is unavailable from the utility company or only provided at cost, utility billings received by tenants are acceptable.
- If utility costs have changed moderately (15 percent or less):
  - ◊ Information regarding rate changes; and
  - ◊ A sampling of individual tenant utility usage.
- If there are no changes in utility rates:
  - ◊ Documentation in the annual budget indicating that no change in rates has occurred during the period being reviewed; or
  - ◊ A public release from the utility provider indicating no change in rates has occurred during the period reviewed.



- If there has been no documentation provided on utility usage during the most recent period:
  - ◊ Documents as if utility costs have changed significantly; or
  - ◊ Letter from utility company saying there has been no increases in rates.

#### **D. Procedure for Reviewing Cost Increase Justifications**

If the reasonableness analysis reveals that the subtotal for any operating expense category—maintenance and operating costs, utilities, administration, or taxes and insurance—exceeds the tolerance threshold, the Loan Servicer should review the budget narrative to determine whether the borrower provided adequate documentation that the expenses for this category are reasonable and necessary. For example, the borrower might provide documentation of the following:

- Costs are comparable to the costs for similar properties in the conventional market. For example, the borrower might show that insurance costs for the same coverage at a conventional project are comparable to the costs for the project shown in the budget.
- The factors contributing to the cost increases are beyond the borrower's control and the borrower is actively implementing cost-containment measures. For example, the project is subject to utility rate or tax increases.
- The cost increase is needed to cover actions to address identified physical deficiencies that are not due to negligence by the borrower or the management agent. Physical deficiencies that are due to negligence by the borrower or the management agent are not acceptable reasons for a rent increase.

If the explanation for the rent increase is not acceptable, the budget should be rejected in accordance with procedures described in Paragraph 4.28.

**Exhibit 4-4****Review for Reasonableness**

The reasonableness review involves three steps as described below:

**Step 1:** Review the operating expenses, income sources, and vacancy allowance.

- **Operating expenses:** Check operating subtotals (O&M, Utilities, Administrative, Telecommunications and Information (T&I)):
  - ◊ Are operating subtotals more than 10 percent different from last year?
  - ◊ Are operating subtotals more than 10 percent different from comparable properties?
- **Income sources:** Check income sources (rental and subsidy, nonrental)
  - ◊ Are income sources more than 10 percent different from last year?
  - ◊ Are income sources more than 10 percent different from comparable properties?
- **Vacancy allowance:** Is the vacancy allowance reasonable? (Historical vacancy rate + 2 percent, up to permissible cap—12 percent for projects with 15 or fewer units, 17 percent for projects with more than 15 units.)
- **Utility allowance:**
  - ◊ Has appropriate documentation been provided to justify the utility allowance?
  - ◊ Does the documentation provided demonstrate that the utility allowance is reasonable and comparable to other projects in this market area?

**If the answer to any of these questions is no, determine whether the budget narrative provides an adequate explanation for the unusual item.** (As discussed in Paragraph 4.24, an adequate explanation might include evidence that other properties have comparable costs, income, vacancies, or utility allowances.)

**Step 2:** Check cash uses. Does the budget reflect the:

- Correct debt payment?
- Reasonable non-operational cash use?
- Correct reserve payment?
- Owner's return on investment?

**If the answer to any of these questions is no, the borrower must submit a corrected budget.**

**Step 3:** Look at the cash flow and ending cash balance.

- **Cash flow:** Is cash flow positive? A negative cash flow is permissible as long as it does not appear to represent a trend that cannot be corrected.
- **Cash balance:**
  - ◊ If cash flow is negative, what is the ending cash? Does it cover the negative cash flow?
  - ◊ Does the ending cash balance exceed the permissible limit? If so, the excess must be contributed to reserves.

**If the analysis of cash flow and cash balance reveals a problem, appropriate servicing actions should be considered prior to budget approval.**

## 4.25 REVIEWING THE RESERVE ACCOUNT

The Loan Servicer must review the reserve account levels and contributions to ensure that they are consistent with the loan agreement. The Loan Servicer will acquire, through independent means, the borrower's project account bank statements to validate the actual reserve account balances during this analysis. This review focuses on four items:

- **Beginning balance.** The Loan Servicer should record the beginning balance of the reserve account and both the total and the per-unit amount.
- **Transfers to reserves.** The Loan Servicer should check the budget to ensure that the appropriate dollar amount, as specified in the loan agreement/loan resolution, is budgeted for deposit in the reserve account. The Loan Servicer should record that amount (the total and per unit amount).
- **Transfers from reserves.** Any transfers from the reserve account that are included in the budget should be described in the budget narrative and justified by the capital plan. The Loan Servicer should record these amounts (total and per unit).
- **Ending balance.** The ending reserve account balance is calculated by taking the beginning balance, adding the transfers to the reserve account, and subtracting the transfers from the reserve account. The Loan Servicer should record this amount on the form as well (both total and per-unit costs).

If the Loan Servicer finds that the reserve account level is not where it is supposed to be, that the budget does not show correct contributions to reserves, or that transfers from reserves are not adequately documented, the borrower must submit corrected budget documents.

## 4.26 REVIEWING THE RENT INCREASE (IF REQUESTED)

Even if the Loan Servicer has determined that the budget is reasonable based on the tests outlined in Exhibit 4-4, the rent increase must still be reviewed to confirm that the rent/utility allowance change will not adversely affect the marketability of the units and create a vacancy problem.

### A. Reviewing the Rent Increase

If a review of the rent increase shows that the rent increase will adversely affect the marketability of units, the full rent increase cannot be approved. The borrower should seek a reduced rent increase and, if appropriate, request a servicing action that will enable the project to achieve a positive cash flow at lower rents. The Agency will not consider rent increases based solely on guaranteeing that the borrower will received an ROI at the end of the project's fiscal year.

## **B. Standard for Allowable Rents for New Projects and Allowable Rent Increases for Special Servicing Actions**

In establishing rents for new projects and for special loan servicing actions such as transfers, reamortizations, and prepayment, the Agency has introduced a market-based measure that serves as a standard for evaluating proposed rent increases. This measure, Conventional Rents for Comparable Units (CRCU), is an objective measure, specific to the quality of the unit that reflects the local market and serves as an indicator of the project's long-term feasibility.

The CRCU standard is a benchmark meant to maintain the affordability of program units and avoid a situation where basic rents are increased above local conventional rents, leading to noncompetitive rents, excessive need for rental assistance, and/or vacancy problems. Sources for determining CRCU include recent appraisals; current rental data from the Census Bureau, HUD, State housing agencies, or other reliable sources; market data provided in applications for new projects in the market area; and the Agency's review of the market. If it appears that an exception under the CRCU standard may be needed, Loan Origination or Loan Servicing staff should contact the National Office for further guidance about making such determinations.

The existence of the CRCU standard does not change the method for increasing rents. Rents remain cost based, which means that they are determined based on the project budget and must be justified by actual operating costs. The CRCU standard does not apply to annual budget submissions that request rent increases.

## **C. Exceptions to the CRCU Standard for New Construction and Special Loan Servicing Actions**

As discussed in HB-1-3560, the Agency can make an exception to the CRCU standard when approving new projects or special servicing actions, and approve basic rents for a property that are higher than the CRCUs for the market area where the property is located, in limited circumstances when it is in the best interest of the Government and the program. The Agency may approve an exception to this standard when it is necessary to allow for decent, safe, and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs.

However, in no case may basic rents exceed CRCUs for a market area by more than 50 percent [7 *CFR* 3560.60(c)(2)]. This upper limit means that basic rents may never be more than 150 percent of the CRCU for the market area where the property is located. For example, if the CRCU for the market area was determined to be \$300 per month, the Agency could approve an exception to allow basic rents for this unit size up to \$450 per month, if there was adequate evidence that a month rent of \$300 was insufficient to cover necessary operating, maintenance, and reserve costs for the proposed property in this area. In no case, however, could the Agency approve rents greater than \$450 per month for a two-bedroom unit.

#### **4.27 RENT CHANGES FOR UNITS RECEIVING HUD SECTION 8 ASSISTANCE** **[7 CFR 3560.207]**

The Agency has the responsibility to review and approve project budgets annually based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer cannot take into account HUD's automatic annual adjustment for HUD Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.

##### **A. Reviewing Budgets with HUD Subsidies**

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have additional information for properties with HUD Section 8 contracts. Exhibit 4-5 lists the additional information needed in the budget, depending upon the project type.

##### **Exhibit 4-5** **Reviewing Budgets with HUD Subsidies**

<b>Project Type</b>	<b>Needed In Budget</b>
<ul style="list-style-type: none"> <li>• <b>100 percent Section 8/515 without interest credit:</b> HUD contract rent rate is equal to basic rent.</li> </ul>	<ul style="list-style-type: none"> <li>• HUD contract rent.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>100 percent Section 8/515 with interest credit:</b> HUD contract rent is greater than basic rent and less than note rate rent.</li> </ul>	<ul style="list-style-type: none"> <li>• Basic rent, HUD contract rent, and Agency note rate rent.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Less than 100 percent Section 8/515 without interest credit:</b> HUD contract rent is greater than note rate rent.</li> </ul>	<ul style="list-style-type: none"> <li>• HUD contract rent and note rate rent; difference is excess funds and deposited into reserves.</li> </ul>
<ul style="list-style-type: none"> <li>• <b>Less than 100 percent Section 8/515 with interest credit:</b> HUD contract rent is greater than basic and less than or greater than note rate rent.</li> </ul>	<ul style="list-style-type: none"> <li>• Basic rent, HUD contract rent, and Agency note rate rent.</li> </ul>

##### **B. Excess Rents**

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 4-5 the borrower may be told to deposit the difference between the Agency-approved note rate rent and the higher HUD-authorized rate into the general operating account. At the end of the year, this excess rent must be deposited into the reserve account. The manager or borrower

must use *Form RD 3560-29, Notice of Payment Due Report*, to document the required deposit in the reserve account.

#### 4.28 APPROVAL OR REJECTION OF BUDGETS

Once the budget analysis is complete, Loan Servicers must notify the borrower if the budget has been approved or rejected.

##### A. Budget Approval

If the Loan Servicer has determined that the borrower represents reasonable costs and has adequately addressed all outstanding compliance issues in the budget narrative, the reserve account is current, and the rent change (if requested) is acceptable, the budget may be approved. To approve the budget, Loan Servicers must sign the budget (*Form RD 3560-7*) and send a copy to the borrower.

##### B. Automatic Budget Approval

Budgets that are not reviewed within the 60-day period are automatically approved unless:

- The budget proposes a monthly rent increase above \$25 per unit; or
- Budgets are submitted late or miss other deadlines set by the Agency.

If a budget is not eligible for automatic approval and no decision is made prior to the beginning of the project's new fiscal year, the borrower must continue operations under the previous year's budget. In these cases, the Agency must continue to work with the borrower to address the requested increase. When agreement is reached, a new budget may take effect.

##### Addressing Rent Increases

Loan Servicers must make every effort to review budgets with significant rent increases within the time limits. Postponing approval is not an acceptable way to address rent increases.

- **Timeframe for automatic approval.** Automatic approval occurs within the following timeframes:
  - ◇ Budgets with no rent increase for automatic approval may be considered approved 30 days after the receipt of a complete budget. Borrowers who submit budgets (with no rent increases) on time and respond to all requests for additional information within the specified time periods can consider their budgets approved 30 days after submission, if they have not received notification from the Agency.
  - ◇ Budgets with rent increases eligible for automatic approval may be considered approved 60 days after the receipt of the original budget. Borrowers who submit budgets (with rent increases) on time and respond to all requests for additional

information within the specified time periods can consider their budget approved 45 days after submission, if they have not received notification from the Agency.

- **Procedure for automatic approval.** In the case of automatic approval, the Loan Servicer must still sign *Form RD 3560-7* and return a copy to the borrower no later than the end of the first month of the project's fiscal year.

### C. Budget Rejection

If the Loan Servicer rejects the proposed budget because it is found to be unacceptable (for reasons related to outstanding monitoring findings, cost reasonableness, reserves, or the rent increase), the borrower has an opportunity to address the deficiencies.

- The Loan Servicer must return the proposed budget to the borrower with a letter listing deficiencies.
- The borrower has 10 days to submit new information to the Agency. The borrower may adjust the size of the rent increase requested or provide new documentation to justify budget items.
- The Loan Servicer must review the new submissions within 20 days of receipt and either approve or reject the budget.
- If the budget is approved based on the new submissions, the Loan Servicer must sign the budget and send a copy to the borrower.
- If the budget is rejected, the Loan Servicer must send the borrower a letter stating the deficiencies and informing the borrower that the previous year's budget remains in effect. The borrower must be given the option to submit a new budget using the previous year's rent levels but adjusted for projected capital expenditures and other known changes for the coming year. The borrower may appeal the budget rejection in accordance with Agency appeal procedures.

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## SECTION 5: REPORTING AND FINANCIAL EXAMINATIONS

### 4.29 MONTHLY AND QUARTERLY REPORTS [7 CFR 3560.307]

#### A. Overview of Reports

Financial reporting provides the Agency and the borrower a means to monitor the project's financial progress.

- **Quarterly reports.** Quarterly reports are required in the following situations:
  - ◊ At completion of new construction or substantial rehabilitation;
  - ◊ When the project is subject to a workout agreement; and
  - ◊ In the case of reamortization and transfer of an existing project loan.
- **Monthly reports.** Loan Servicers may require borrowers to prepare and submit these reports on a monthly basis when additional tracking and supervision are needed. (For example, when a project is subject to a workout agreement, when there has been a violation of program rules or reporting requirements, or when the project shows signs of financial distress.)

Loan Servicers may discontinue the reporting requirement for projects that have demonstrated consistent compliance with program requirements over a sufficient time period. Generally 12 months of consistent compliance is considered sufficient to discontinue the reporting requirements.

#### B. Review of Monthly and Quarterly Reports

The borrower must submit the required reports to the Agency at the end of each period (quarter or month, as appropriate). Upon receipt, the Loan Servicer must review these reports for the following:

- Look for red flags such as dramatic changes in income, expenses, the general operating account, or the reserve account.
- Check balances on accounts as discussed in Paragraph 4.3, to make sure that they are consistent with the management plan, loan agreement/resolution, and the budget.
- Check project expenditures against the budget. Make sure that the project is being operated in accordance with the approved budget.
- Check progress against workout agreements. Make sure that the borrower is taking any actions indicated in a workout agreement and is abiding by the established schedule for these actions.

#### 4.30 ENGAGEMENTS AND PREPARATION OF ANNUAL FINANCIAL STATEMENTS [7 CFR 3560.308]

##### A. Overview of Requirements for Annual Financial Statements

To ensure that the project is in sound financial condition and is complying with the program financial management requirements, the Agency requires annual financial statements to be submitted by each borrower. The borrower must submit *Form RD 3560-7* with actual expenditures and *Form RD 3560-10, Borrower Balance Sheet* within 90 days of the end of the project's fiscal year. These requirements differ by the type of project.

##### 1. Requirements for Large Projects

Large projects—defined as projects with 16 or more units—must base their annual financial reports on an engagement report completed according to agreed-upon procedures established by the Agency. Borrowers must include the engagement report with their annual financial reports submitted to the Agency. This report must follow specific requirements as set forth in the RHS Multi-Family Housing Audit Program (**Attachment 4-B**). The annual financial statements may be completed by a certified public accountant (CPA) or another individual with the training and experience to prepare the report. The borrower must initiate the engagement report using the Agency's engagement letter, which will specify the engagement program and establish the reporting requirements for the engagement. Borrowers will be required to use the model engagement letter prepared by OIG. The National Office should be contacted to obtain the model engagement letter.

- The annual financial statements must be completed using agreed-upon procedures that help meet the performance standards described in the RHS Multi-Family Housing Audit Program (**Attachment 4-B**). It must be initiated by the borrower using an engagement letter, which will either:
  - ◊ Reference the RHS Multi-Family Housing Audit Program (**Attachment 4-B**), which will specify the program compliance issues that the Agency wants the CPA or other qualified individual to address, and guidelines for testing compliance; or
  - ◊ State the compliance issues that the Agency wants the CPA or other qualified individual to address.
- The annual financial statements must be prepared by the CPA or other qualified individual, in accordance with American Institute of Certified Public Accountant (AICPA) Standards and Agency requirements, based on the results of the engagement.
- All submissions must be prepared for ultimate use by the Agency.

## 2. *Requirements for Small Projects*

Small projects—defined as projects with fewer than 16 units—must submit annual financial statements in accordance with the required limited-scope engagement.

- The annual financial statements may be prepared by a CPA or other qualified individual; and
- Note: Borrowers may be required to obtain and submit audits for these properties, and the costs would be an allowable project expense; borrowers must self-certify that the project meets the performance standards described in Exhibit 4-6.

### **Exhibit 4-6**

#### **Performance Standards**

The CPA or other qualified individual must ensure that:

- Required accounts are properly maintained and tracked separately;
- Payments from operating accounts are disclosed and accurately represented;
- Reserve amount is current (i.e., contributions are on schedule and balance accounts for contributions less authorized withdrawals), and there are no encumbrances;
- Tenant security deposit accounts are fully funded and are maintained in separate accounts;
- Payment of owner return was consistent with the terms of the applicable loan agreement or loan resolution;
- Borrower/grantee has maintained proper insurance in accordance with the requirements of 7 CFR 3560.105; and
- All financial records are adequate and suitable for examination.

### **3. *Other Requirements***

- **Requirements for nonprofit and public bodies.** Nonprofit and public borrower entities must submit annual financial statements in accordance with the requirements established by the Office of Management and Budget (OMB) and must also include the requirements set forth in the limited scope engagement.
- **Additional opinions.** The Agency may require additional opinions of financial condition and compliance, such as annual financial statements, to assure the security of the asset; to determine whether the project is being operated at a reasonable cost; or to detect fraud, waste, or abuse.
- **Annual financial reports.** Any project annual financial statements independently obtained by the borrower must be submitted to the Agency for review.

#### **B. Agency Review of Annual Financial Reports**

Loan Servicers must review financial statements—in accordance with guidelines provided in Exhibit 4-7—to ensure that they meet Agency requirements. In particular, Loan Servicers must:

- Confirm that the engagement was conducted by a qualified person as described in the requirements above;
- Confirm that nonprofit and public bodies have submitted the OMB-required annual financial statements; and
- Note any problems identified in the examination, and determine appropriate corrective actions.

Loan Servicers should use the Annual Agency Review of the Engagement results to guide their review of the examination results.

**Exhibit 4-7****Agency Review of Annual Financial Statements**

- A. **Analysis of actual income and expenses.** Using the actual budget submitted, record the actual income and expenses and note any unexpected variance. In doing so, address the following questions:
- Did the expenses in any of the main categories—maintenance and operating costs, utilities, administration, and taxes and insurance—differ by more than 10 percent from their proposed levels?
  - Did the actual sources of income (rental, subsidy, and nonrental) differ by more than 10 percent from their proposed levels?
  - Was the vacancy allowance in the permissible range?
  - Were debt payments and reserve payment correct?
  - Was nonoperational cash use reasonable (as compared to last year)?
  - Was the cash flow positive?
- B. **Account maintenance, tracking, and disclosure.** Record the account balances from the report and confirm that the financial report states that:
- Required accounts are maintained and tracked separately; and
  - Payments from operating accounts are disclosed and accurately represented.
- C. **Reserve account status.** From the financial report, record the amounts listed for the reserve balance, deposits, and withdrawals, and confirm that the financial report states that the reserve account is current and that there are no encumbrances on the reserve account funds.
- D. **Tenant security deposit account status.** Record the tenant security account balance from the financial report and confirm that the report shows that the tenant security deposit balance meets liabilities and that the funds are maintained in a separate account and in accordance with state law.
- E. **Payment of return to owner.** Confirm that the financial report states that the payment of the owner's return was consistent with the terms of the loan agreement or resolution. Record the actual return paid and its effect on cash flow, using the actual project budget.
- F. **Insurance status.** Confirm that the financial report states that all relevant insurance requirements were met.
- G. **Taxes and other assessments.** Confirm that the financial report states that taxes and other assessments are current. List any taxes or assessments that are not current.
- H. **Issues of financial compliance and conditions.** Confirm in the financial report that any funds used for unauthorized purposes have been repaid.
- I. **Payment of management fees.** Using the actuals in the financial report, confirm that the management fee was paid in accordance with the management certification and that the management agent is not charging the project for agent expenses.

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## **ATTACHMENT 4-A**

### **ELIGIBLE PROJECT EXPENSES**

There are generally accepted project expenses that should be charged to the operating account. Some of these expenses are listed below:

1. Actual direct personnel costs of permanent and part-time staff assigned solely to the project site. This includes managers, maintenance staff, and temporary help for both types of positions and can cover the following specific items:
  - a. Gross salary;
  - b. Employer FICA contribution;
  - c. Federal unemployment tax;
  - d. State unemployment tax;
  - e. Workers compensation insurance;
  - f. Health insurance premiums;
  - g. Cost of fidelity or comparable insurance;
  - h. Leasing, performance incentive, or annual bonuses;
  - i. Direct costs of travel to off-site locations by onsite staff for property business or training; and
  - j. Retirement benefits.
2. Legal fees directly related to the operation and management of the property, including tenant lease enforcement actions, property tax appeals and suits that result in a savings to the project and have prior Agency approval, and all legal and other project-relevant matters.
3. All outside accounting fees, if required by RHS, directly related to the preparation of the annual financial report, partnership tax returns, and K-1s, as well as other outside reports and year-end reports to RHS, HUD, HFA, or other governmental agency. (Preparation of income tax returns for project owners is not an acceptable expense.)
4. Repair and maintenance costs for the project may include:
  - a. Maintenance staffing costs and related expenses;
  - b. Maintenance supplies;
  - c. Contract repairs to the projects (heating and air conditioning, painting, roofing, etc.);
  - d. Make-ready expenses including painting and repairs, flooring replacement, and appliance replacement, as well as drapery/mini-blind replacement (turnover maintenance);
  - e. Preventive maintenance expenses including repairs and maintenance of occupied units, as well as repairs and maintenance of common area systems;
  - f. Costs of snow removal;
  - g. Costs of elevator repairs and maintenance contracts;
  - h. Costs of Section 504 compliance;
  - i. Costs of landscaping maintenance, replacements, and seasonal plantings;
  - j. Costs of pest control services; and
  - k. Other related maintenance expenses.

5. Specific costs that may be charged to the Property are as follows:

- a. The costs of credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.
- b. The costs of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.
- c. All bank charges related to the Property, including purchases of supplies (stamps, checks, deposit slips, service fees, etc.).
- d. Costs of site-based telephone, including initial installation, basic services, directory listings, and long distances charges.
- e. All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.
- f. Postage and delivery costs from the site, including expenses in mailing the material to RHS, HUD or other governmental agencies; tenants; verifying third parties; central management offices, etc.
- g. Partnership filing expenses including state taxes and other mandated state or local fees as well as other relevant expenses, costs of continuation financing statements, and site license and permit costs.
- h. Expenses related to site utilities, including actual costs and surcharges, as well as deposits and expense of utility bonds in lieu of bonds.
- i. Expenses related to industry interface and communications with main office. Site office furniture and equipment, including site-based computer and copiers, are included. Service agreements and warranties for copiers, telephone systems, and computers are also included (if approved by the Agency—see Chapter 3 of HB-3-3560 for a discussion of automated systems and industry interface).
- j. Real estate taxes (personal/tangible property and real property taxes).
- k. All costs of insurance, including property liability and casualty, as well as fidelity or crime and dishonesty coverage for onsite employees.
- l. Costs of collecting rents onsite including bookkeeping supplies and record keeping items.
- m. Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies, and other associated expenses—total expenses will no exceed \$20 per unit per year.
- n. Public relations expenses relative to maintaining positive relationships between the local community and the tenants, and the management staff and the owners. Chamber of Commerce duties, contributions to local charity events, sponsorship of tenant activities, etc., are examples of such expenses. Total expenses will not exceed \$20 per unit, per year.
- o. Tax credit compliance monitoring fees imposed by HFAs.
- p. All insurance deductibles as well as adjuster expenses.
- q. Professional service contracts (engagements, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.).
- r. Training of site staff.
- s. Site manager salary for additional hours.
- t. Offset taxes on serve income (phantom income).



## ATTACHMENT 4-B

### AUDIT PROGRAM



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

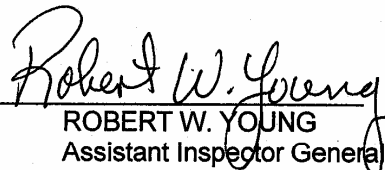


<b>AUDIT PROGRAM</b>	Rural Development Rural Housing Service Multi-Family Housing Division Rural Rental Housing Program

This audit program provides instruction and guidance for independent public accountants in conducting agreed-upon procedures engagements of recipients of Rural Development loans, except for those audits required to be performed in accordance with Office of Management and Budget Circular A-133. The audit program is effective for the period ending December 31, 2005, and thereafter.

This audit program may not be changed, altered, revised, or modified without the concurrence of the Office of Inspector General.

APPROVED BY:

  
ROBERT W. YOUNG  
Assistant Inspector General  
for Audit

9/29/04  
Date

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- III. **ANNUAL AGREED-UPON PROCEDURES FOR THE ANNUAL ATTESTATION ENGAGEMENT**

EXHIBIT A – ILLUSTRATIVE AUDITOR’S AGREED-UPON  
PROCEDURES REPORT (FORM RD 1924-13 OR  
FORM RD 3560-7)

**I. GENERAL**

**A. PURPOSE**

This guide is designed to assist independent public accountants (“practitioners”) in conducting agreed-upon procedures engagements of Rural Rental Housing (RRH) properties financed by Rural Development. The RRH Program has a history of abuse involving the construction and ongoing operation of properties. This guide includes procedures to assist the practitioner in determining borrower and management company compliance with certain statutory, regulatory, and contractual requirements of the RRH Program. Thus, practitioners need to be familiar with laws, regulations, and procedures related to the RRH Program.

**B. BACKGROUND**

Rural Development uses cost certifications to verify that borrowers spent loan funds for eligible and actual costs when constructing apartment complexes as part of the RRH Program. Rural Development requires borrowers to annually report the financial operations of RRH properties on *Form RD 3560-7, Multiple Family Housing Project Budget*.

RRH borrowers typically use identity-of-interest companies in both the construction of apartment complexes and in managing the day-to-day operations of RRH properties. RRH borrowers that have an identity-of-interest with the borrower (general contractor) are required by Rural Development to report the actual costs of construction on *Form RD 1924-13, Estimate and Certificate of Actual Cost*. In addition, *Form RD 1924-13* must be submitted whenever there is an identity-of-interest relationship between a borrower and a subcontractor, material supplier, or equipment lessor.

The USDA Office of Inspector General has performed audits and investigations that identified significant fraud and abuse in the RRH Program. Some of the fraud and abuse related to construction includes: Ineligible, unsupported, and duplicate costs; misrepresentation by borrowers of their roles as general contractors; shifting costs (e.g., overhead expenses) that exceeded budgeted amounts to different cost categories on *Form RD 1924-13*; and using identity-of-interest companies which are merely “shell” companies to either inflate legitimate charges or bill properties for costs that were never incurred.

Similar abuse using identity-of-interest companies has been identified in the ongoing management of RRH properties. Borrowers and management companies also charge ineligible, unsupported, and duplicate expenses (generally for management related costs) to properties. Also, management companies frequently do not maintain suitable records when using employees to perform maintenance of properties, and overcharge for these services. Rural Development regulations refer to any scheme that improperly withdraws funds from RRH project accounts as “equity skimming”.

USDA Office of Inspector General audits have also identified instances of conflicts of interest and a lack of independence on the part of certified and licensed public accountants when performing audits of RRH properties. Thus, practitioners should strictly adhere to the standards and principles of the American Institute of Certified Public Accountants' Code of Conduct and Bylaws and applicable State Boards of Accountancy.

**C. PERTINENT REGULATIONS AND INSTRUCTIONS**

**Construction Cost:**

The instructions for *Form RD 1924-13* provide guidance on eligible construction costs, as well as the required format for the presentation of costs. Rural Development has also established regulations that restrict the amount of builder's profit for each project, the use of identity-of-interest companies, and the business relationships of practitioners performing engagements of RRH construction costs. The following regulations and Rural Development instructions should be used as guidance:

- Rural Development Instruction 1924-A, and
- Rural Development Instruction 1944-E.

**Management of Ongoing Operations:**

Rural Development regulation RD 3560 provides details on allowable and unallowable operating costs, and places restrictions on the use of identity-of-interest companies and other activities related to managing RRH properties. The instructions for *Form RD 3560-7* also provides direction on eligible costs.

**D. STANDARDS FOR CONDUCTING THE AGREED-UPON PROCEDURES ENGAGEMENTS**

Practitioners are to perform attestation engagements using agreed-upon procedures of construction costs and ongoing operations in accordance with attestation standards established by the American Institute of Certified Public Accountant's (AICPA) and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States." The practitioner's report on agreed-upon procedures should be in the form of procedures and findings. (See exhibit A for an illustrative example.)

If practitioners become suspicious of fraud or illegal acts during the course of performing the agreed-upon procedures engagement, they are to promptly report these matters (regardless of materiality) to:

U.S. Department of Agriculture  
Rural Development  
Rural Housing Service  
Director, Multi-Family Housing Processing Division  
14<sup>th</sup> and Independence Avenue SW  
Washington, D.C. 20250  
(202) 720-3773

The report and workpapers prepared in the course of these engagements are subject to a quality control review by the USDA Office of Inspector General.

**E. OBJECTIVES**

The objective of the construction cost engagement is to verify the propriety of costs reported on *Form RD 1924-13*. The practitioner should be alert for kickbacks on the purchase of services and materials, billings in excess of agreed-upon prices, billings for nonexistent materials or services, “sweetheart contracts,” and the diversion of materials to other construction sites.

The objective of the ongoing operations engagement is to verify the propriety of operating and maintenance expenses reported to Rural Development on *Form RD 3560-7*, Part II, and reserve account activity reported on *Form RD 3560-7*, Part III. The practitioner should be especially alert for equity skimming schemes involving maintenance costs, and unauthorized withdrawals from reserve and tenant security deposit accounts.

Of primary concern is compliance with general contractor and management company requirements and the role of identity-of-interest companies in the construction and management of RRH properties.

## **II. CONSTRUCTION COST ENGAGEMENTS**

### **A. AGREED-UPON PROCEDURES FOR THE CONSTRUCTION COST ATTESTATION ENGAGEMENT**

The procedures in this section are designed to identify ineligible expenses and fictitious charges to Forms RD 1924-13. RD Regulations 1924-A and the instructions for preparing *Form RD 1924-13* provide guidance on eligible construction costs.

Borrowers and contractors involved in the construction of Rural Development financed RRH properties are required to maintain recordkeeping systems which establish accounts that categorize costs in conformity with sections 1924.13 (e) (1) (v) (A) and 1924.13 (e) (2) (i) (H) of Rural Development Instruction 1924-A. *Form RD 1924-13* includes a certification that the cost of labor, materials, and other necessary services incurred during construction are accurate and fairly presented.

Borrowers are required to comply with laws, regulations, and Rural Development procedures related to the construction of RRH properties. USDA Office of Inspector General audits have identified borrowers that received builder's profit for being the general contractor when, in fact, general contractor responsibilities were being performed by other contractors. The audits also disclosed that some identity-of-interest companies were merely "shell" companies with no employees, inventory, or other business activities. Other identity-of-interest companies have charged rental fees for equipment use for the entire construction period when the equipment was actually used for short or intermittent periods during construction.

These actions have resulted in significant amounts of overcharges to RRH properties. Sections 1924.13 (e) (1) (v) (H) and 1924.13 (e) (2) (viii) of Rural Development Instruction 1924-A prohibit borrowers from receiving builder's profit for acting as the general contractor if more than 50 percent of the property is subcontracted to one subcontractor or 75 percent to three or fewer subcontractors. Sections 1924.13 (e) (1) (I) and 1924.13 (2) (viii) of Rural Development Instruction 1924-A require that before a borrower can claim expenses paid to an identity-of-interest company, it must also provide services and/or materials to the general public and not just to RRH properties.

#### **Agreed-Upon Procedures**

1. Compare the total amount paid through the construction checking account (by adding the total amount from monthly statements) to the total amount of costs reported on *Form RD 1924-13*. Report any differences.
2. Examine selected checks, invoices, job cost ledgers, receiving documentation, etc., that support costs presented on *Form RD 1924-13* to ensure they were actually incurred to construct the project. (Note: Verify

that checks have been cancelled and ensure that indirect costs are not included with the cost of labor and materials on *Form RD 1924-13*.)

3. Inspect selected checks held as retainage from subcontractors for evidence that they were actually paid by the bank. Confirmation with subcontractors may be necessary if cancelled checks are not available or not cancelled by the bank. (Note: Office of Inspector General audits have disclosed instances where checks were made to subcontractors, but never cashed.)
4. Compare the address on selected delivery documents and invoices (using the sample from audit step II.A.2.) to the project's address to ascertain whether materials and services were provided to the project under review. (Note: Office of Inspector General audits have disclosed instances where delivery was not made to the RRH project site.)
5. Examine selected cancelled checks related to accounts included in the "to be paid" column of *Form RD 1924-13* to determine the propriety of the costs reported. (Note: Office of Inspector General audits have disclosed instances where these costs were invoiced by identity-of-interest companies, but were never actually paid by the borrower.)
6. Confirm payments with selected subcontractors and material suppliers and investigate any discrepancies. (Note: Be alert for any discounts, rebates, or refunds that were provided to the contractor but not included on *Form RD 1924-13*.)
7. Inspect selected bid documentation to verify that the lowest bid submitted was accepted. If the lowest bid was not accepted, evaluate the justification for the higher bid. If documentation does not exist, report this and the reason why as a finding. (Note: Be alert for "sweetheart contracts" and contracts to disclosed or undisclosed identity-of-interest companies.)
8. Compare selected subcontractor billings (invoices) to contract amounts. If billings were in excess of contractual terms, ascertain the reason for the higher expense.
9. Obtain the number of subcontractors used during construction and calculate the percentages of subcontractors to ensure compliance with Rural Development requirements.<sup>1</sup>

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<sup>1</sup> Sections 1924.13 (e) (1) (v) (h) and 1924.13 (2) (2) (viii).

10. Examine selected accounting records for undisclosed identity-of-interest companies. The practitioner should focus on transactions involving the use of one or two contractors/subcontractors, or if one contractor/subcontractor provided a significant percentage of materials or services.
11. Determine if identity-of-interest companies meet Rural Development requirements<sup>2</sup> of providing services to the general public.
  - a. Question the general contractor/borrower about the business activities of any identity-of-interest company used and request evidence that the company provides services or materials to the general public.
  - b. Review identity-of-interest records (e.g., sales records, invoices, receiving documents, etc.).
  - c. Confirm by independent verification that identity-of-interest companies exist and provide services to the general public. (Note: This evidence could include listings in a telephone directory, advertisement to the public, etc. Also, be alert for “shell” companies that exist solely for processing invoices and adding markups to the original supplier’s invoices. Markups made by identity-of-interest companies that do not provide services/supplies to entities other than the RRH property are not allowable.)
12. Compare equipment rental and supervision charges by identity-of-interest companies to independent rental companies to determine reasonableness<sup>3</sup> of charges. Report any significant variances.
  - a. Question the borrower about the use of equipment during construction and how rental rates were established and time of use determined.
  - b. Contact an independent rental company to determine commercial rental rates and compare them to the identity-of-interest charges.
  - c. Examine borrower documentation (e.g., commercial rate lists, time sheets, construction schedules, etc.) to support the rates that were used and time that was charged for equipment rental fees. (Note: Office of Inspector General audits have disclosed that borrowers are charging rental fees when equipment is not in use.)

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<sup>2</sup> Sections 1924.13 (e) (1) (I) and 1924.13 (2) (viii).

<sup>3</sup> A charge would be considered reasonable if it is approximately the same amount of cost that a non identity-of-interest company would charge.



- d. Question the borrower about supervision charges.
- e. Verify that the borrower has documentation (e.g., timesheets or timecards, travel reports, payroll records, etc.) to support supervision charges.

### **III. ANNUAL AGREED-UPON PROCEDURES ENGAGEMENTS**

#### **A. AGREED-UPON PROCEDURES FOR THE ANNUAL ATTESTATION ENGAGEMENT**

The Office of Inspector General has identified significant fraud and abuse of operating and maintenance expenses in the RRH Program. The procedures in this section are designed to assist practitioners in identifying ineligible charges and misused funds reported on *Form RD 3560-7*, Part II, Operating and Maintenance Expense Schedule and Part III Account Budgeting/Status. RD Regulation 3560 provides requirements for owners and management companies participating in the RRH Program, particularly those involving identity-of-interest companies. The procedures in this section are designed to identify noncompliance with these requirements.

The most common occurrence involves identity-of-interest companies that are merely “shell” companies with no employees, inventory, or other business activities. In these instances, owners and management companies use identity-of-interest companies to inflate costs from legitimate vendors or bill the properties directly for work that was never performed. While Rural Development requires the disclosure of identity-of-interest companies, many owners and management companies fail to comply with this requirement.

#### **Agreed-Upon Procedures**

1. Compare the total amount paid from the operating and maintenance bank account (by adding the total amount from monthly statements) to the total amount of costs reported on the general ledger and *Form RD 3560-7*, Part II.
2. Examine selected receipts, invoices, cancelled checks, etc., that support operating and maintenance expenses presented on *Form RD 3560-7*, Part II, to ensure they were actually incurred during the ongoing operations of the project. The practitioner should focus on line items 1-10, and 19-32. (Note: Do not accept photocopies of receipts or invoices and be alert for invoices that appear to be altered, have duplicate invoice numbers, or that are not pre-printed.)
3. Compare selected operating and maintenance records pertaining to expenses on *Form RD 3560-7*, Part II, to RD regulations for eligibility and reasonableness. Practitioners should use professional judgment in determining the reasonableness of charges.
4. Confirm payments with selected vendors for maintenance and operating expense items (or any questionable charges) from *Form RD 3560-7*, Part II. (Note: Discounts, rebates, or refunds should be credited to the property’s account.)

5. Confirm with the financial institution year-end reserve account balances on *Form RD 3560-7*, Part III, and that there are no encumbrances of reserve account funds.
6. Calculate the number of reserve account withdrawals from bank statements. This number is to be included in the engagement report. (Note: Original bank statements should be used for this analysis and be alert for transfers and automatic withdrawals from the reserve account.)
7. Examine the caretaker agreement for compliance with Rural Development requirements<sup>4</sup>. (Note: Office of Inspector General audits have disclosed instances where caretaker duties included services paid for in the management fee.)
8. Examine documents to confirm that owners/management companies solicited bids from independent companies for services/materials that were provided by identity-of-interest companies.
9. Determine who owns selected contractor companies from the applicable State agency (for example Secretary of State records) and compare to RRH project owner and management company ownership names to uncover undisclosed identity-of-interest companies.
10. Compare the address on selected work orders, delivery documents, invoices, remittance notices, etc., to the RRH project address to ensure that services/supplies were provided to the appropriate property.
11. Confirm by independent verification that identity-of-interest companies exist and provide services to the general public. (Note: The evidence could include listing in a telephone directory, advertisement to the public, etc. Also, be alert for “shell” companies that exist solely for processing invoices and adding markups to the original supplier’s invoices. Markups made by identity-of-interest companies that do not provide services/supplies to entities other than RRH property are not allowable.)

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<sup>4</sup> RD Regulation 3560.102(b)(1)(ii)

**Illustrative Auditor's Agreed-Upon Procedures Report**

**(Form RD 1924-13 or Form RD 3560-7)**

To the Owners and Management Company of *(name of RRH project, city and State)* and the project's financial accounts:

We have performed the procedures enumerated below, which were agreed to by Rural Development and the owner of *(name of RRH project, city and State)* and the project's financial accounts, solely to assist those parties in evaluating the accompanying *(Form RD 3560-7, Multiple Family Housing Project Budget or Form RD 1924-13, Estimate and Certificate of Actual Cost)* prepared in accordance with the criteria specified in Rural Development Regulations 1924 and 3560 for the year ended December 31, *(applicable year)*. The owner is responsible for *(name of the RRH project)* financial accounts. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of Rural Development. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The agreed-upon procedures performed during this engagement were included in the audit program designed for the Rural Rental Housing Program dated September 29, 2004. The findings for each of the agreed-upon procedures are as follows.

*(Agreed –Upon Procedure No.)      (Finding)*

*(Agreed –Upon Procedure No.)      (Finding)*

*(Agreed –Upon Procedure No.)      (Finding)*

*(etc)*

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the financial statements of *(name of RRH project, city and State)*. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the owner and management company of *(name of RRH project, city and State)*, and Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

*(Signature)*

*(DATE)*

## **CHAPTER 5: PROJECT PHYSICAL CONDITIONS**

### **5.1 INTRODUCTION**

The existing portfolio of multi-family housing projects constitutes a major asset of the Government and the Agency, but the value of this asset depends upon the quality of its upkeep. This chapter describes the responsibilities of borrowers to maintain the physical condition of the project and of the Agency to exercise appropriate oversight of these responsibilities. The chapter describes the components of adequate physical maintenance, the role of the management plan, and the performance of a physical inspection of the project.

### **SECTION 1: PROJECT MAINTENANCE [7 CFR 3560. 103]**

### **5.2 PURPOSE**

The Agency has issued performance standards that describe the physical condition of a properly managed project. The Agency's interest in protecting the physical condition of projects that it has financed include:

- Providing decent, safe, and sanitary affordable housing to the occupants;
- Protecting and enhancing the security of its investment; and
- Assuring compliance with all applicable State and local laws.

### **5.3 MAINTENANCE REQUIREMENTS AND STANDARDS OF PHYSICAL CONDITIONS**

#### **A. Standards of Physical Conditions**

Borrowers are responsible for the long-term, cost-effective preservation of the housing project. The Agency has specified two types of requirements borrowers must meet:

- Performance standards for the project; and
- Procedures and systems that property managers must design and follow.

#### **B. Performance Standards**

The regulations in 7 CFR 3560.103(a)(3) specify the performance standards for meeting acceptable physical conditions. The performance standards describe the characteristics the Agency expects to see in a particular component or system, for example:

“The housing project must have a foundation that is free of evidence of structural failure, such as uneven settlement indicated by horizontal cracks or severe bowing of the foundation wall. Structural members must not have evidence of rot or insect or rodent infestation.

The housing project must have a roof that is free of leaks, defective covering, curled or missing shingles and which is not sagging or buckling.”

The performance standards have been incorporated into a physical inspection form to be completed by Agency staff during a site visit. They also have been incorporated into the certifications that accompany the management agreement for the project.

The standards include the following major categories:

- Standards that apply to the site on which the project is located;
- Standards that apply to the exterior maintenance of the building and of the common areas;
- Standards that apply to the interior of the building or buildings; and
- Standards that apply to common areas, such as hallways or elevators.

### C. Maintenance Systems and Procedures

Effective maintenance is partly the result of regular routines and partly the result of promptly fixing small problems before they become major ones. Proper maintenance has a direct effect on the tenants’ perception of the quality of the housing project. Therefore, the Agency requires borrowers to institute a number of systems and procedures that the borrower must describe in the project’s management plan. The requirements for a management plan are described in Chapter 3.

Several systems are part of a sound management program:

- **Preventive maintenance.** Much maintenance work can be predicted and scheduled—this is typically described as preventive maintenance. The Agency requires managers to spell out procedures for scheduling routine tasks, such as garbage and trash removal, snow and ice removal, grounds upkeep, routine painting, and minor repairs. Procedures are also required for the routine maintenance of equipment consistent with service information provided by the manufacturer—biweekly or monthly routine oiling, adjusting, replacement of filters, safety checks of alarms, and outside lighting, etc.
- **Response to calls.** Good upkeep requires a speedy response to complaints or unforeseen problems. The Agency requires managers to establish a system for responding to tenant complaints or to unexpected malfunctions or damage, such as leaks, broken windows, etc.

- **Work orders.** Managers must know what has happened from the time a complaint has been received or a problem has been noted, to an inspection confirming the condition has been corrected. The Agency requires the project to have a work-order system that tracks the date a complaint is received, the inspection to verify the complaint, a report describing the required repair or corrective action, the assignment of the repair, the completion report, and final inspection noting satisfactory completion of the work.
- **Inspections.** Frequent, regular inspections are a major component of an effective maintenance system. The Agency requires management, at a minimum, to perform an annual inspection of each occupied unit and to inspect each unit at move-in and move-out. Inspecting a unit with the tenant at move-in and move-out establishes the condition of the unit at the time the tenant takes possession, and may help clarify responsibility for any damages that have occurred in the unit during the occupancy period.
- **Energy conservation.** Energy conservation efforts are an ongoing responsibility of project management. The Agency requires managers to establish effective systems to reduce energy consumption. These may include energy audits to determine cost-effective techniques of energy conservation, energy-efficient lighting, water-saving fixtures, low-flow toilets, energy-efficient appliances, insulation, caulking and weather-stripping, storm doors and windows, and regular cleaning and replacement of filters and other equipment.
- **Tenant damages.** The Agency requires management to establish a policy and implement a system to obtain reimbursement for damage caused by the tenant to the property beyond normal wear and tear. The policy is to be stated in the tenant's lease as described in **Attachment 6-B**.
- **Accessibility issues.** The Agency requires the borrower and/or management to establish a policy regarding project and unit accessibility for applicants, tenants, and employees in accordance with applicable civil rights legislation.
  - ◇ In projects that were ready for occupancy on or before January 26, 1993, when public areas are altered, they must be altered to Americans with Disabilities Act Accessibility Guidelines (ADA/AG) standards. (Public areas are those areas used by individuals other than tenants and their guests. This includes offices used to pay bills or to inquire about service or employment, public restrooms, and buildings used for voting or public meetings.)
  - ◇ In projects that were ready for occupancy after January 26, 1993, public areas must be designed and constructed to ADA/AG standards.
  - ◇ In accordance with the Fair Housing Act, in Multi-Family Housing projects that were ready for occupancy on or before March 31, 1991, FHA/AG architectural requirements do not apply, even during project rehabilitation.

- ◇ In Accordance with the Fair Housing Act, in multi-family housing projects that were ready for occupancy after March 13, 1991:
  - ◆ All ground floor units in buildings with four or more dwelling units must be designed and constructed in a manner that is adaptable to individuals with disabilities.
  - ◆ All units must be adaptable if there is an elevator.
  - ◆ Covered Multi-Family Housing projects must have:
    - ✓ An accessible entrance on an accessible route;
    - ✓ Accessible public and common-use areas;
    - ✓ Usable doors;
    - ✓ Accessible routes into and through the dwelling unit;
    - ✓ Accessible light switches, electrical outlets, and environmental controls;
    - ✓ Reinforced bathroom walls; and
    - ✓ Usable kitchens and bathrooms.

The electronic Multi-Family Housing Project Management and Occupancy Review Form available in Multi-Family Information System (MFIS) includes space for the Loan Servicer to comment on the adequacy of the maintenance systems adopted by project management.

#### **D. Requirements for Labor Housing**

There are no separate performance standards for year-round labor housing and rental or cooperative housing. Seasonal labor housing must meet conventional performance standards and must have insulation as necessary to protect the facility during the off-season period.

### **5.4 CORRECTING DEFICIENCIES**

The borrower is responsible for adequate maintenance and upkeep of the project that complies with Agency performance standards. The Agency understands, however, that property maintenance is an ongoing process and that there may be instances when diligent borrowers are temporarily unable to achieve 100 percent compliance with Agency standards. In such instances, the Agency will not penalize borrowers—as long as it is evident that the borrower is actively striving to return to full compliance, as soon as possible (see the standards listed in 7 CFR 3560.103).



This flexibility is not extended to projects where the deficiencies are so extensive that the property would be declared in substantial noncompliance. In these instances, the projects' viability is called into question, as well as the effectiveness of the management's maintenance program.

The borrower shall immediately inform the Agency of any deficiency for which correction requires repairs that cannot be paid out of project operating funds and immediately initiate procedures to access project reserves (see Section 2 of this chapter). The Agency will in turn provide the borrower with a timeframe for completing the repairs. If the borrower cannot meet the Agency required timeframe, then they must provide documentation and justification why they cannot meet such a timeframe.

There are a number of ways in which the need for maintenance is identified:

- Management staff may uncover, anticipate, or expect such maintenance;
- Tenants may make complaints; and
- Agency staff may identify defects in the course of a site visit.

No matter how the problem was identified, the borrower is responsible for correcting it.

## 5.5 PAYING FOR MAINTENANCE EXPENSES

Maintenance is paid for in two ways:

- Routine physical maintenance, such as repainting an empty unit, replacing a broken window, snow removal, or grounds upkeep, is part of the operating budget and paid for out of annual operating income.
- Major capital expenditures are paid for by withdrawals from the reserve account. Capital expenditures are addressed as long-term improvements on the front of the operating budget.

### **Rule-of-Thumb**

A capital expenditure is typically defined as an expenditure on an item for which the useful life is greater than one year. For example:

- Repaving the parking lot is a capital cost; fixing a pothole is an operating cost.
- Painting is more difficult to classify. Repainting the exterior of the entire project is a capital expenditure; interior repainting could be either.

Section 2 of this chapter describes the process for accessing the reserve account to pay for major capital improvements.

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## **SECTION 2: USING RESERVES FOR PHYSICAL MAINTENANCE**

### **5.6 ELIGIBLE USES**

With prior written consent of the Agency, the borrower may use reserve account funds to:

- Pay for repairs to housing, furniture, or equipment damaged by long-term depreciation or emergencies;
- Make permanent improvements to the housing project, such as installing an energy-conserving heat pump or making a unit accessible to persons with disabilities; or
- Meet an emergency shortfall in operating expenses when the emergency is beyond the control of the borrower and threatens life, safety, or the physical security of the project. Examples might include an extreme weather disaster or reductions in rental income caused by changes in the rental market that affect other housing projects as well.

### **5.7 PLANNED USE OF RESERVES**

The Agency expects borrowers to anticipate and plan for major capital expenditures at least annually. The borrower is required to submit an annual capital expenditure budget as part of the annual budget submission. The Loan Servicer reviews these documents, as well as the annual report of actual expenditures to ensure that the borrower includes expenditures adequate to maintain the property to Agency standards. This should include plans to catch up with any maintenance expenses deferred from previous years, or to correct any deficiencies identified during Agency site visits.

The borrower must submit a written request to the Agency to use reserve funds, even if the Agency has reviewed and approved the capital expenditures in its review of the annual capital budget. The borrower must obtain cost estimates for proposed repairs/replacements.

### **5.8 UNANTICIPATED USES OF RESERVES**

The Agency recognizes that not all capital expenditures can be predicted a year in advance. Sometimes a major piece of equipment will break down unexpectedly or a severe storm will create damage. Borrowers must seek Agency approval for the unforeseen use of reserves. In emergency situations when the borrower can demonstrate an imminent and serious threat to the health, safety, or physical security of the project, the borrower may request the Agency to postapprove the use of reserves. The Agency will only approve emergency withdrawals if the reserves are used for eligible expenses.

The Agency may approve a borrower's request to increase the required level of the reserve account to ensure sufficient funds are available to address capital requirements of a transition plan. The use of reserve funds to address the capital requirements identified by the borrower's transition plan may be considered an authorized use of reserve account funds. Loan funds may also be used for this purpose.

## 5.9 THE WITHDRAWAL PROCESS

### A. Common Procedure

The procedures that the borrower and the Agency use vary with the complexity and cost of the project for which reserve funds are sought. However, some steps are used in all cases:

- The borrower writes the Field Office using *Form RD 3560-12, Request For Authorization To Withdraw Reserve Funds* to request the use of reserve funds for a capital expenditure. The request will include:
  - ◇ A statement of the purpose and a description of the item for which reserves will be used;
  - ◇ The current balance in the account and other activity, such as deposits and withdrawals;
  - ◇ The estimated cost of the item;
  - ◇ Copies of bids, if appropriate;
  - ◇ A copy of the approved capital budget that included the item or an explanation of why the item was not included in the annual capital budget; and
  - ◇ A statement of the current balance in the reserve account.
- The Servicing Office reviews the request:
  - ◇ If the request is for an item—other than a substantial construction activity—that was included in the annual capital budget and approved during the Agency review of the engagement report, the Servicing Office must complete its review within 5 calendar days.
  - ◇ If the request is for a capital expenditure that is not an emergency and was not part of the annual capital budget, the Servicing Office has 10 calendar days to complete its review.
- The Servicing Office notifies the borrower in writing of the decision to:
  - ◇ Approve the request;
  - ◇ Approve the request with conditions; or
  - ◇ Reject the request (this must include the reasons for rejection and an explanation of the borrower's appeal rights).

- The borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

## **B. Bid Requirements**

Reserves may be used to purchase or replace capital items, which involve no modification to the structure of the project. Borrowers often obtain bulk prices for these items, which are good for a year. Any purchase over \$3,500 will require a minimum of two bids.

## **C. Projects Involving Moderate Levels of Construction**

These are projects that do not involve any substantial changes to the structure or replacement of major systems and cost less than \$100,000. Examples could include exterior repainting, roof repair, parking lot repaving, and repairs to plumbing or electrical systems. When the borrower requests access to reserves for a moderate construction activity, the Agency first reviews the construction documents and then reviews a payment request.

In addition to the items specified in Paragraph 5.9 A, the borrower must provide:

- The specifications for the activity and of the work to be performed;
- Copies of written bids;
- A rationale for awarding the contract; and
- A copy of the contract/proposal.

Once the item has been approved, the borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

## **D. Larger Construction Items**

These activities involve substantial changes to the structure, replacement of major systems, or expenditures in excess of \$100,000. Such activities are subject to the construction requirements of RD Instruction 1924-A, including:

- A detailed description of the project, including specifications and drawings;
- A copy of the bid documents; and
- A copy of the construction contract once the Agency has approved the bidding process.

Once the construction contract has been approved by the Agency, the borrower may request an initial draw to pay for materials or make a down payment to the contractor.

The request for an initial draw should be accompanied by invoices and a check made out to the contract or vendor, to be cosigned by the Agency. The Agency may approve such a request provided the amount of the initial draw does not exceed a reasonable percentage of the value of the construction contract. All such payments will include appropriate Agency retainages.

The Agency will inspect the project before approving the work and again at construction completion before approving the final draw. The purpose of the initial inspection is to establish that the proposed work is needed and is an appropriate response to existing conditions. The purpose of the final inspection is to establish that the work was performed as approved by the Agency and according to Agency construction standards. The Agency may conduct additional inspections as it sees fit.

#### **E. Projects Involving an Identity-of-Interest Between Borrower and Contractor**

Where there is an identity-of-interest (IOI) between the borrower or property manager and the contractor or vendor, bids will be required for all expenditures from reserves that exceed \$3,500 annually. This helps ensure that the Agency will obtain contracts, materials, supplies, utilities, and services on the most advantageous terms to the project. The Agency will secure and credit to the borrower all discounts, rebates, or commissions obtainable with respect to purchases, service contracts, and all other transactions on the borrower's behalf.

The entity with the IOI must submit its bid directly to the Servicing Office, prior to requesting bids from other firms. The Agency requires at least two bids from other firms or an explanation of why the borrower was unable to obtain two bids.

## **SECTION 3: CAPITAL PLANNING**

### **5.10 OVERVIEW**

This section describes how borrowers, with assistance from Agency staff, can plan for major capital expenses and how to pay for them. This type of planning can take many forms. The two most common forms used by the Agency are an annual capital expenditure budget and a capital needs assessment.

### **5.11 ANNUAL CAPITAL EXPENDITURE BUDGET**

#### **A. The Role of the Borrower**

The borrower identifies major maintenance and replacement needs during the annual budget cycle and develops a schedule for making withdrawals from the reserve account to pay for their cost. These plans are incorporated by the borrower into the annual capital expenditure budget, and may also be reflected in the operating budget if the work is to be paid for out of operating income.

#### **B. Agency Review**

The Loan Servicer uses the budget cycle to assess the borrower's annual capital expenditure budget compared with available information about the types of capital improvements needed to maintain the project's physical condition.

The Loan Servicer reviews the operating and annual capital budgets, and compares them with previous budgets, site visit reports, physical inspections, capital needs assessments, and audit reports. When doing so, the Loan Servicer should consider the following questions:

- Are expenditures sufficient to maintain the project according to the Agency's performance standards and the requirements of the project management plan?
- Were any essential items of maintenance deferred during the past year, which should be financed from the upcoming operating or capital budget?
- Are there any uncorrected defects noted in site visit reports that should be financed from the upcoming operating or capital budget?
- Has a capital needs assessment of the property been prepared?
- Is the amount budgeted for maintenance and replacement reserve expenditures sufficient to address immediate capital needs?
- If capital needs information is available, are replacement reserve contributions and funding levels sufficient to address anticipated capital needs over the next 5 years?

If the Loan Servicer finds the operating and capital budgets inadequate to keep the project in compliance with Agency standards for physical conditions [7 CFR 3560.103], the Loan Servicer must request the borrower to modify the annual capital plan. The Loan Servicer may also request modifications if it is found that the borrower has proposed expenditures to be paid from reserves that should be charged to the operating account.

## **5.12 CAPITAL NEEDS ASSESSMENT**

### **A. Overview**

The Agency encourages borrowers to develop a capital needs assessment for each project, based on an analysis of the life-cycle of major building components and systems, equipment, and exterior elements, such as the building's facade, driveways, and parking lots. The capital needs assessment includes a replacement analysis that anticipates the useful life of each of these items, and estimates the point at which they will need to be replaced and the cost of their replacement. Preparation of this capital needs assessment is an eligible project expense, provided the assessment is reasonable in cost and meets Agency requirements.

### **B. Required Skills**

Preparation of a capital needs assessment usually requires the services of:

- An engineer and/or architect who inspects to assess the expected life of building systems and who develops the initial replacement analysis; and
- An expert in finance who can project the level of reserves, including accumulated interest, that the replacement budget will require.

In some instances the services of a cost estimator may also be needed. Experienced property managers usually can accurately estimate the point at which various types of equipment need to be replaced.

### **C. Determining a Project's Capital Needs**

The amount required for deposit into the replacement reserve account is established for new projects during the loan origination phase, based in part on a life-cycle cost analysis of the materials going into the project and its major design features (see 7 CFR 3560.65). For information on conducting life-cycle analyses, refer to Chapter 3 of HB-1-3560.

For existing projects, the Agency encourages the development of a capital needs assessment in the following circumstances:

- When ownership of the project is transferred;
- When the loan is reamortized;



- When there is a writedown of the project loan; or
- At the borrower's request.

**D. Agency Review**

Capital needs assessments and a proposed, updated annual operating budget, including a revised capital plan and any proposed increase in contributions to replacement reserves and project rents, are submitted to the Field Office for Agency review. Loan Servicing Staff should review the requests based on direction from the National Office and the budget review procedures in Chapter 4.

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## **SECTION 4: AGENCY OVERSIGHT OF BORROWER PERFORMANCE**

### **5.13 OVERSIGHT DURING DESIGN AND CONSTRUCTION**

Agency oversight of the borrower's capacity to maintain the physical project in compliance with its standards and requirements begins during the loan origination phase. As part of its design review, the Agency examines plans and working drawings to see whether the project has been designed for easy maintenance and long-term durability.

Borrowers must describe the systems and procedures that will be used to maintain the project during the occupancy period in the management plan. Agency staff review the proposed management plan for compliance in accordance with procedures described in Chapter 3. Agency staff should analyze the description of the maintenance systems in the management plan, noting any points that appear unrealistic, incomplete, or incorrect.

### **5.14 OVERSIGHT DURING THE FIRST YEAR OF OPERATION**

Projects in the first year of operation are subject to intensive oversight by the Field Office. The borrower must file frequent reports and Agency staff must conduct two site visits, the first within 90 days of initial occupancy and the second within 12 months of the first. These visits can be used by Agency staff to establish that management has installed the procedures and systems the Agency requires for project maintenance.

The construction contractor or the suppliers are usually still responsible for correcting physical defects that may emerge during the warranty period. The Agency holds the borrower responsible for ensuring the correction of any such defects.

### **5.15 ANNUAL OVERSIGHT**

#### **A. Financial Reviews**

The Servicing Office reviews project finances at least twice each year:

- It reviews the proposed budget for the project; and
- It reviews the annual financial reports.

These reviews provide Servicing Office staff with an opportunity to establish whether appropriate expenditures for maintenance occurred during the year just completed and are projected for the coming year.

During the budget review, the Loan Servicer checks whether the operating budget and the annual capital budget proposed for the coming year appear adequate. The Loan Servicer may use comparisons with projects of similar size and age, site visit reports and other project records, and the long-term capital plan to determine whether there are outstanding findings that require additional improvements to the physical condition of the project.

The review of the annual financial report provides final information on actual expenditures for physical maintenance in the completed fiscal year, and identifies any discrepancies between budgeted and actual expenses for this purpose. Instances of deferred maintenance should be followed up with project management.

## **B. Annual Physical Inspection**

The Field Office will conduct an annual physical inspection, known as a “walk-about,” in the year between formal physical inspections. This review does not require prior notice to the borrower or manager. Its purpose is to determine, quickly, that project maintenance complies with Agency requirements. If the Field Office notes any maintenance problems, staff will schedule a follow-up physical inspection

During the review, Field Office staff check and photograph exteriors, sites, and public spaces of the project. Staff should review the inspection package the Agency has developed prior to making the site visit. The package includes an explanation of how each component of the physical plant relates to tenant health and safety, and a description of the performance standard for each component. The major components to be reviewed are listed in Exhibit 5-1. These are the items listed under the “Exterior/Inspection” section of *Form RD 3560-11, Multi-Family Housing Physical Inspection Report*.

<b>Exhibit 5-1</b>	
<b>Major Components to be Inspected at an Annual Physical Review</b>	
•	Utilities;
•	Drainage and erosion control;
•	Landscaping/grounds;
•	Drives, parking areas, and walks;
•	Exterior signs;
•	Fences and retaining walls;
•	Debris and graffiti;
•	Exterior lighting;
•	Foundation;
•	Exterior walls and siding;
•	Roof, flashing, and gutters;
•	Windows, doors, and exterior structures;
•	Common area accessibility; and
•	Common area signs.

The inspection form includes a section in which the results of these inspections are noted. If the review indicates there are major problems or deficiencies at the site, the Field Office will schedule a full-blown physical inspection of the project. The walk-about is intended to take no longer than a half hour to complete. Its primary purpose is not to inspect for full compliance with all applicable maintenance standards, but to identify any potentially serious problems that require immediate attention.

## **C. Three-Year Physical Inspection**

The Field Office must schedule and perform a formal physical inspection of each project at least once every 3 years until the loan is repaid in full. In addition, the Field Office makes physical inspections to projects that are delinquent or evidencing problems. The purpose of physical inspections is to allow the Agency to view the physical conditions of a project firsthand and make sure the property and its buildings are being maintained according to Agency standards. The procedures for completing a physical inspection are discussed further in paragraph 9.12.

### ***1. Pre-Inspection Actions***

Prior to the inspection, the Loan Servicer reviews project files to note any previously identified maintenance issues and reviews the annual budget and annual financial report to identify instances of deferred maintenance. Prior site visit reports, annual budgets for capital expenditures, and any long-term capital plans are key documents for this review.

### ***2. The Site Visit***

The Loan Servicer performs a physical inspection of the project exterior and of a sampling of occupied and vacant units. Performance standards for project maintenance have been incorporated into the project inspection form. The Loan Servicer should review the inspection package the Agency has developed prior to making the site visit. The package includes an explanation of how each component of the physical plant relates to tenant health and safety, and a description of the performance standard for each component. The major components to be examined are listed in Exhibit 5-2.

The Loan Servicer uses the inspection form to note whether each performance standard has been met, and to add other comments.

<b>Exhibit 5-2</b> <b>Major Components to be Examined in a Physical Inspection</b>	
<b>Exterior</b>	<b>Interior</b>
<ul style="list-style-type: none"> <li>• Utilities;</li> <li>• Drainage and erosion control;</li> <li>• Landscaping/grounds;</li> <li>• Drives, parking areas, and walks;</li> <li>• Exterior signs;</li> <li>• Fences and retaining walls;</li> <li>• Debris and graffiti;</li> <li>• Exterior lighting;</li> <li>• Foundation;</li> <li>• Exterior walls and siding;</li> <li>• Roof, flashing, and gutters;</li> <li>• Windows, doors, and exterior structures;</li> <li>• Common area accessibility; and</li> <li>• Common area signs.</li> </ul>	<ul style="list-style-type: none"> <li>• Flooring;</li> <li>• Walls, floors, and ceilings;</li> <li>• Doors and windows;</li> <li>• Electrical, AC, and heating;</li> <li>• Water heaters;</li> <li>• Smoke alarms;</li> <li>• Emergency call systems (if applicable);</li> <li>• Insect/vermin infestation;</li> <li>• Range and hood;</li> <li>• Refrigerator;</li> <li>• Sinks;</li> <li>• Cabinets;</li> <li>• Water closet;</li> <li>• Bathtub and shower stall; and</li> <li>• Fully accessible units.</li> </ul>

### ***3. Analyzing and Categorizing Inspection Findings***

The Agency recognizes that not all failures to meet performance standards are of equal magnitude. It has established guidelines for rating the seriousness of defects ranging from Levels I through III, in which Level I is the most serious, constituting a major threat to health and safety. The inspection package, which consists of forms and instructions, includes an explanation of these levels and categorizes performance standard deficiencies by level. These forms are referenced in Chapter 9.

- Projects with Level III defects have minor maintenance items that can be corrected within 1 month; during this period the project may continue to receive Federal subsidies.
- Projects with Level II defects require some major maintenance that can be performed within 6 months; during this period the project may continue to receive Federal subsidies.
- Projects with Level I defects are not considered eligible for Federal subsidy. Level I physical defects that are not corrected immediately may affect the health and safety of tenants. Because of the serious consequences of this designation, this rating can only be given after review and concurrence by the State Director but Federal subsidy cannot be terminated until the borrower has exhausted all appeal rights.

## CHAPTER 6: PROJECT OCCUPANCY

### 6.1 INTRODUCTION

The purpose of this chapter is to present the occupancy rules for multi-family housing projects and the Agency's procedures for determining borrower compliance. Agency procedures for ensuring borrower compliance are summarized at the end of the chapter.

### **SECTION 1: TENANT ELIGIBILITY REQUIREMENTS [7 CFR 3560.152]**

#### 6.2 GENERAL ELIGIBILITY—INCOME ELIGIBILITY AND CITIZENSHIP

To be admitted to multi-family housing, applicants must meet three basic requirements.

- Have income that does not exceed the limits defined by the Agency;
- Be a U.S. citizen or qualified alien; and
- Meet the program definition of an eligible household.

A borrower may determine an applicant ineligible for occupancy based on screening criteria other than those required by the Agency only if such criteria are included in the project's management plan. The screening criteria may not contain arbitrary or discriminatory rejection criteria, but may consider an applicant's past rental and credit history and relations with other tenants.

#### 6.3 INCOME REQUIREMENTS

Three different income limits are used to establish eligibility for Multi-Family Housing programs. The National Office determines the income limits and updates the limits whenever they are revised. Adjusted income should be compared with the below-listed income limits to determine the category in which each household falls:

- The very low-income limit is established at approximately 50 percent of the median income for the area, adjusted for household size;
- The low-income limit is established at approximately 80 percent of the median income for the area, adjusted for household size; and
- The moderate-income limit is established by adding \$5,500 to the low-income limit for each household size.

The borrower has the right to determine a minimum income level for households of various sizes for applicants who will not be receiving rental assistance. These guidelines must be administered consistently for all potential applicants.

## 6.4 CITIZENSHIP STATUS

To be eligible for Agency assistance, the applicant must be a U.S. citizen, a U.S. noncitizen national, or a qualified alien, and must provide acceptable evidence of eligible immigration status. Any applicant who is not a U.S. citizen, a U.S. noncitizen national, or a qualified alien should be rejected. U.S. noncitizen nationals should provide a copy of their birth certificate or passport as evidence of their status. Aliens must provide acceptable evidence that they are qualified aliens. The Loan Servicer should review the original document and make legible photocopies of both the front and back. If the documentation appears to be altered or counterfeit, or if the alien presents unfamiliar Department of Homeland Security (DHS) documentation, the Loan Servicer must contact the DHS for verification. *Form G-845 S, Verification for SAVE Agencies*, may be used for this purpose. All current citizenship-related forms may be found at the U.S. Citizenship and Immigration Services (USCIS) website: <http://uscis.gov>. For further information on verifying citizenship or eligible immigration status, refer to the Systematic Alien Verification for Entitlements (SAVE) Program website at <http://uscis.gov/graphics/services/SAVE.htm>. This website provides immigration status verification guidance for benefit issuing Agencies.

### U.S. Citizens

Never ask about alien status if the applicant is a U.S. citizen. Always require evidence if the applicant is a qualified alien.

### U.S. Noncitizen Nationals

Noncitizen nationals are persons born in American Samoa or Swains Island or after the date the U.S. acquired American Samoa or Swains Island, or a person whose parents are U.S. noncitizen nationals. Always require evidence of this relatively uncommon status.

## 6.5 DETERMINING AN ELIGIBLE HOUSEHOLD

Although it may seem obvious, deciding who is a part of an applicant's household is an important, but not always simple, task. The word "household" applies to individuals and family members who intend to live in a unit.

### A. Defining a Household

Deciding who can be considered a household member affects many decisions the borrower must make, including:

- The number of bedrooms the family needs;
- The members' income that must be counted and the income limits that should be used;
- The extent to which the family qualifies for certain income deductions and certain preferences; and
- The household member who can sign legal documents.



## B. Who Can Be Counted as a Household Member?

A household may be made up of a variety of members and may have a specific definition. The following are examples of members and types:

- **Elderly families:** A household where the tenant, co-tenant, member, or co-member is at least 62 years old, disabled, or handicapped as defined below. An elderly family may include a person younger than 62 years of age who is essential to the care and well-being of the person who is elderly and/or disabled or handicapped. (To receive an elderly family deduction, the person who is elderly, disabled, or handicapped must be the tenant, cotenant, member, or co-member.)
- **Individual with disability.** A person is considered disabled if the person meets either of the following criteria:
  - ◇ The person has an inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment, where the disability:
    - ◆ Has lasted or can be expected to last for a continuous period of not less than 12 months, or which can be expected to result in death; and
    - ◆ Substantially impedes the ability to live independently; and
    - ◆ Is of such a nature that the ability to live independently could be improved by more suitable housing conditions; or
    - ◆ A sight-impaired individual (as defined by Section 223 of the Social Security Act) who is at least 55 years old and is unable to engage in substantial gainful activity in which he/she has previously engaged with some regularity over a substantial period of time.

Receipt of Veteran's or Social Security Disability payment benefits for disability, whether service-oriented or otherwise does not automatically establish disability.

- ◇ The person has a developmental disability, a severe, chronic disability that:
  - ◆ Is attributable to a mental or physical impairment or combination of mental and physical impairment; and
  - ◆ Was manifested before age 22; and
  - ◆ Is likely to continue indefinitely; and
  - ◆ Results in substantial functional limitations in three or more of the following areas of major life activity:
    - ✓ Self-care;

- ✓ Receptive and expressive language;
  - ✓ Learning;
  - ✓ Mobility;
  - ✓ Self-direction;
  - ✓ Capacity for independence; and
  - ✓ Economic self-sufficiency.
- ◆ Reflects the person's need for a combination and sequence of special, interdisciplinary, or generic care or treatment, or for other services which are of lifelong or extended duration and are individually planned and coordinated.
- **Individual with handicap.** A person with a physical or mental impairment that:
    - ◇ Is expected to be of long-continued and indefinite duration; and
    - ◇ Substantially impedes the person or is of such a nature that the person's ability to live independently could be improved by more suitable housing conditions.

The term handicap further means, with respect to a person, a physical or mental impairment that substantially limits one or more major life activities, a record of such an impairment, or being regarded as having such an impairment. This term does not include current illegal use of or addiction to a controlled substance. As used in this definition, physical or mental impairment includes:

- ◆ Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological, musculoskeletal, special sense organs, respiratory (including speech organs), cardiovascular, reproductive, digestive, genito-urinary, hemic and lymphatic, skin, and endocrine; or
- ◆ Any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term "physical or mental impairment" includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech and hearing impairments, cerebral palsy, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, human immunodeficiency syndrome (AIDS), mental retardation, emotional illness, drug addictions (other than addiction caused by current, illegal use of a controlled substance), and alcoholism.

Major life activities mean functions such as caring for one's self, performing major tasks, walking, seeing, hearing, speaking, breathing, learning, and working.

Having a record of such an impairment means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities.

A person who is regarded as having an impairment:

- ◆ Has a physical or mental impairment that does not substantially limit one or more major life activities but that is treated by another person as constituting such a limitation;
  - ◆ Has a physical or mental impairment that substantively limits one or more major life activities only as a result of the attitudes of others toward such impairment; or
  - ◆ Has one of the impairments defined above but is treated by another person as having such an impairment.
- **Household.** One or more persons who maintain or will maintain residency in one rental or cooperative unit, but not including a resident assistant or chore service worker.
  - **Resident assistant.** A person residing in a tenant's housing unit who is essential to the well-being and care of the persons who are elderly or have handicaps or disabilities residing in the unit, but is not obligated for the person's financial support and would not be living in the unit except to provide the needed support services. While the resident assistant may be a family member, the resident assistant may not be a dependent of the household for tax purposes and is not subject to the eligibility requirements of a tenant or member. A resident assistant is not a chore service worker. A resident assistant may function in any type of housing affected by this section.
  - **Foster children.** Eligible families may include foster children, as long as the children do not cause overcrowding. However, foster children are not considered family members for the purposes of determining income or deductions from income, or to determine household size to compare with income limits.
  - **Remaining family members.** Remaining members of resident families are family members who stay in a unit after other members of the household leave. These members will be reevaluated for eligibility in accordance with Section 7 of this chapter. Agency regulations may require remaining tenants to move to a unit of appropriate size or exit the project.
  - **Students.** A student or other seemingly temporary resident of the community who may be considered an eligible tenant when all of the following conditions are met:
    - ◇ The student is of legal age in accordance with the applicable state law or is otherwise legally able to enter into a binding contract under state law;
    - ◇ The person seeking occupancy has established a household separate and distinct from the person's parents or legal guardians;

- ◇ The person seeking occupancy is no longer claimed as a dependent by the person's parents or legal guardians pursuant to Internal Revenue Service regulations, and evidence is provided to this effect; and
- ◇ The person seeking occupancy signs a written statement indicating whether or not the person's parents, legal guardians, or others provide any financial assistance and this financial assistance is considered as part of current annual income and is verified in writing by the borrower.

## **6.6 ADDITIONAL REQUIREMENTS FOR ELDERLY UNITS, CONGREGATE HOUSING, AND GROUP HOMES**

In addition to the requirements listed in Paragraph 6.2, applicants for elderly units, congregate housing, or group homes must meet the additional requirements described below.

### **A. Elderly Units and Congregate Housing**

To be admitted to elderly units or congregate housing:

- Applicants and tenants must qualify as an elderly household or be granted a waiver by the Agency. Waivers are permitted only under the following circumstances:
  - ◇ The borrower has made reasonable efforts to lease to elderly households.
  - ◇ The borrower has been granted approval by the Agency to lease to age-ineligible households. Agency approval will be of limited duration.
  - ◇ The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure.
  - ◇ The leasing to age-ineligible households will be for a limited period until the unit can be rented to an elderly household.
  - ◇ The borrower will continue efforts to locate eligible elderly households for tenancy.
- Nonelderly persons are eligible for occupancy as long as they are members of an elderly household and live in the same unit.
- Priority can be given to tenants who agree to participate in the services provided by the facility.

### **B. Group Homes**

To be admitted to a group home:

- Applicants/tenants must be in need of the special services provided by the group home.

- Applicants must demonstrate a need for such housing and cannot be required to be a part of an ongoing training or rehabilitation program.
- Applicants must be selected from the market area prior to considering applicants from other areas.

A group home may limit occupancy to a specific group of tenants (e.g., eligible elderly tenants, developmentally disabled or mentally impaired tenants) if it is outlined in the borrower's management plan.

## **6.7 INELIGIBLE TENANT WAIVERS**

The Agency may authorize the borrower in writing, upon receiving the borrower's written request with the necessary documentation, to rent vacant units to ineligible persons for temporary periods to protect the financial interest of the Government. Likewise, this provision may extend to a cooperative. This authority will be for the entire project for periods not to exceed one year. Within the period of the lease, the tenant may not be required to move to allow an eligible applicant to obtain occupancy, should one become available. The Agency must make the following determinations.

- There are no eligible persons on a waiting list.
- The borrower provided documentation that a diligent but unsuccessful effort to rent any vacant units to an eligible tenant household has been made. Such documentation may consist of advertisements in appropriate publications, in several public places, and in other places where persons seeking rental housing would likely make contact; holding open houses; and making appropriate contacts with public housing agencies and organizations, Chambers of Commerce, and real estate agencies.
- The borrower agrees to publish a notice in the local newspaper to inform the public of the borrower's intent to temporarily rent apartments to all persons without regard to age or income restrictions.
- The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure and the Agency's approval of the waiver will be for a limited duration.
- That the lease agreement will not be more than 12 months and at its expiration will convert to a month-to-month lease. The monthly lease will require that the unit be vacated upon 30 days' notice when an eligible applicant is available.
- Tenants residing in Rural Renting Housing (RRH) units who are ineligible because their adjusted annual income exceeds the maximum for the RRH projects will be charged the RHS approved note rate rental rate for the size of unit occupied in a Plan II RRH project. In projects operated under Plan I, ineligible tenants will be charged rental surcharge of 25 percent of the approved note rate rental rate. Plan I and Plan II projects are defined in 7 CFR 3560.11.

- Tenants residing in Off-Farm Labor Housing (LH) units who are ineligible because their adjusted annual income exceeds the maximum for the area will be charged the lesser of the LH project's note rate rent or the prevailing market rent rate for the project. For on-farm tenants, rent determination may be subject to local discretion within limitations contained in 7 CFR part 3560, subpart M. Excess rent will be deposited into the project's reserve account.

## SECTION 2: CALCULATING INCOME AND INITIAL CERTIFICATION

### 6.8 CALCULATION OF TENANT INCOME

Borrowers use tenant income information to: (1) help determine whether an applicant is eligible to reside in multi-family housing; (2) calculate the applicant's ability to pay rent; and (3) determine the amount of rental assistance the household is eligible to receive. This section provides guidance for calculating and verifying income for each of these purposes.

#### A. Key Concepts for Income Determinations

##### 1. *Income Definitions*

Two income definitions are used: annual income and adjusted income. Whenever income determinations are made, it is essential that borrowers use the correct income definition and consider income from the appropriate household members.

- **Annual income.** Annual income is used as the base for computing adjusted income. Income of all household members should be considered when computing annual income. **Attachment 6-A** can be used to determine which sources of income to count and which to exclude. *Form RD 3560-8, Tenant Certification* illustrates the calculation of annual income. Paragraph 6.8 B in this section provides additional information on calculating annual income.
- **Adjusted income.** Adjusted income is used to determine whether an applicant is income eligible to reside in multi-family rental housing or to receive rental subsidies. For guidance on calculating adjusted income, see Paragraph 6.8 C in this section.

##### 2. *Projecting Income for a 12-Month Period*

Current income and family circumstances may be used to estimate the household's income over the next 12 months, unless there is verifiable evidence of a likely change in circumstances. Historical information may be used to estimate income that is anticipated to be received for less than 12 months. For example, if one of the household members is a seasonal worker, the income attributable to that worker should be based upon past history, rather than annualizing current income.

#### **Example—Annualizing Short-Term Income**

Assume a family member who currently has no income historically has seasonal income during the summer months and earns on an average of \$4,000 during that time. Confirm with the applicant that the same seasonal pattern is expected and use historical data to project income for the coming 12 months.

### 3. *Income of Temporarily Absent Household Members*

Members may be temporarily absent from the household for a variety of reasons, such as temporary military duty activation, temporary employment, or students who live away from home during the school year. The income of these household members is considered when computing annual income. Households with a member permanently confined to a hospital or nursing home may choose to either include annual income attributable to such person, less deductions for which the person would qualify, or exclude the annual income attributable to such person and not take any deductions for which the person would qualify.

#### **Example—Temporarily Absent Member**

James Brown and his wife have applied for a unit. At the moment, James is working on a construction job on the other side of the state and comes home every other weekend. He earns \$600 per week and uses approximately one-third of that amount for temporary living expenses. The full amount of the income earned would be counted for both repayment and annual income.

### **B. Calculating Annual Income**

**Attachment 6-A**, Annual Income Sources, provides a list of possible sources of income and indicates whether each source is counted for or excluded from annual income.

### **C. Calculating Adjusted Income**

Adjusted income is used to determine eligibility for Multi-Family Housing programs, as well as eligibility for and the amount of payment subsidies under rental assistance.

Adjusted income is calculated by subtracting from annual income any of five deductions that apply to the household. Not all households are eligible for all deductions. Exhibit 6-1 summarizes these deductions. The remainder of this paragraph provides guidance on determining whether a family is eligible for each deduction and verifying and calculating these amounts.

<b>Exhibit 6-1</b>		
<b>Allowable Deductions from Annual Income</b>		
<b>Deduction</b>	<b>Elderly Households</b>	<b>Nonelderly Households</b>
Dependent deduction	Yes	Yes
Child care expenses	Yes	Yes
Elderly household	Yes	No
Disability assistance	Yes	Yes
Medical expenses	Yes	No



### ***1. Dependent Deduction***

A deduction from annual income of \$480 is made for each household member who qualifies as a dependent. Dependents are household members who are not the head or spouse and who are age 17 or younger, an individual with a disability, or a full-time student. If an applicant requests a deduction for dependents attending school full time, the applicant must provide documentation from the school that the dependent is enrolled as a full-time student.

### ***2. Child Care Expenses***

Reasonable unreimbursed child care expenses for the care of children age 12 and under are deducted from annual income if: (1) the care enables a household member to work or go to school; (2) no other adult household member is available to care for the children; and (3) in the case of child care that enables a household member to work, the expenses deducted do not exceed the income generated by that household member. If the child care provider is a household member, the cost of the children's care cannot be deducted.

To qualify for the deduction, the applicant must:

- Identify the children who are receiving the child care and the household member who can work or go to school as a result of the care;
- Demonstrate that there is no adult household member available or able to care for the children;
- Identify the child care provider, the hours of child care provided, and the costs; and
- If the expenses enable a household member to go to school, identify the educational institution. The household member need not be a full-time student.

#### **Verification of Child Care Expenses**

Child care hours must parallel the hours the household member works or goes to school. An acceptable format for verifying child care expenses is a letter on the child care provider's letterhead or a copy of a signed child care contract.

### ***3. Elderly Household Deduction***

A single \$400 deduction is made from annual income for any elderly household. To be considered an elderly household, the head of household, spouse, or sole member of a household who is party to the lease must be 62 years of age or older, or an individual with a disability.

In the case of a family where the deceased applicant or spouse was at least 62 years old or an individual with disabilities, the surviving household members may continue to reside in a housing project after the departure or death of the tenant or co-tenant, provided that:

- They are eligible with respect to adjusted income;
- The surviving household members occupied the dwelling with the deceased member at the time of death;
- They execute a tenant certification form establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Nonelderly or nondisabled surviving members of an elderly or disabled household are not entitled to the elderly family adjustment to income.

#### **4. Deductions for Disability Expenses**

Reasonable expenses for the care of an individual with disabilities in excess of three percent of annual income may be deducted from annual income if the expenses:

- Enable the individual with disabilities or another household member to work;
- Are not reimbursable from insurance or any other source; and
- Do not exceed the amount of income earned by the person who is able to work as a result of the expenses.

Along with other forms of documentation, to qualify for this deduction applicants must identify the individual with a disability on the application.

##### **Typical Disability Assistance Expenses**

- Care attendant to assist an individual with disabilities with activities of daily living directly related to permitting the individual or another household member to work.
- Special apparatus, such as wheelchairs, ramps, and adaptations to vehicles or workplace equipment, if directly related to permitting the individual with disabilities or another household member to work.

##### **Typical Medical Expenses**

- Services of physicians other healthcare providers;
- Services of hospitals other healthcare facilities;
- Medical premiums;
- Prescription and nonprescription medicine;
- Dental expenses;
- Eyeglasses and eye examinations;
- Medical or health products or apparatus (hearing aids, wheel chairs, etc.);
- Live-in or periodic medical care (e.g., visiting nurses or care attendants);
- Bandages, syringes, continence shields, and other nonprescription items recommended by a physician; and
- Periodic payments on accumulated medical bills.

### 5. *Deduction for Medical Expenses (for elderly households only)*

Medical expenses may be deducted from annual income for elderly households if the expenses (1) will not be reimbursed by insurance or another source; and (2) when combined with any disability assistance expenses are in excess of three percent of annual income.

If the household qualifies for the medical expenses deduction, expenses of all members are considered. For example, if a household included the head (grandmother, age 64), her son (age 37), and her granddaughter (age 6), the medical expenses of all three household members would be considered.

One of the most challenging aspects of determining allowable medical expenses is estimating a household's medical expenses for the coming year. While some anticipated expenses can be documented easily (for example, Medicare or other health insurance premiums and ongoing prescriptions), others need to be estimated. The borrower should use historical information about medical bills to estimate future expenses. However, the estimates should be realistic. For example, if the household has a significant medical bill, the borrower would count only that portion of the bill that is likely to be paid during the coming year.

#### **Example – Calculating the Medical Expense Deduction**

The Jensons are an elderly household with annual income of \$25,000 and anticipated medical expenses of \$3,000 that are not covered by insurance or another source. The allowable medical expenses would be:

Total medical expenses	\$3,000
(less) 3% annual income (\$25,000 x 0.03)	<u>-\$ 750</u>
Allowable medical expenses	\$2,250

## 6.9 EVALUATING APPLICANTS' ASSETS

Assets can affect an applicant's ability to be qualified as an eligible tenant. Many types of assets generate income that must be included in the calculations of annual income. Exhibit 6-2 presents a list of assets that must be considered when making these determinations and also identifies certain types of assets that are not considered.

### **A. Reporting Assets**

Applicants must provide information about household assets at the time of application and whenever an income is reverified. Applicants must provide sufficient information to enable the borrower to verify the asset information and compute the market and cash value of the asset.

**Exhibit 6-2****Types of Assets**

**The following types of assets must be considered.**

Nonretirement assets including:

- Savings accounts and the average six-month balance of checking accounts;
- Stocks, bonds, savings certificates, money market funds, and other investment accounts;
- Equity in real property or other capital investments;
- Trust funds that are available to the household;
- Lump sum receipts, such as inheritances, capital gains, and lottery winnings;
- Personal property (such as jewelry) held as an investment; and
- Cash value of life insurance policies.

Retirement assets including:

- Amounts in voluntary retirement plans that can be withdrawn, such as individual retirement accounts (IRAs), 401(K) plans, and Keogh accounts; and
- Amounts in other retirement and pension plans that can be withdrawn without retiring or terminating employment.

**The following types of assets are not considered.**

- The value of necessary items of personal property, such as furniture and automobiles;
- Assets that are part of any business, trade, or farming operation in which any household member is actively engaged;
- The value of an irrevocable trust fund, or the value of any trust over which no household member has control; and
- Interests in American Indian trust land.

## **B. Calculating Market and Cash Value**

The market value of an asset is simply its dollar value on the open market. For example, the market value of \$2,000 in a savings account is \$2,000 and the market value of real estate is its appraised value. The cash value of an asset is the market value, less reasonable expenses to convert the asset to cash. For example, the cash value of stock worth \$5,000 would be \$5,000 less any broker's fee.

## **C. Retirement Assets**

Retirement assets are savings and investments that have been specifically designated as retirement funds. Not all retirement assets are considered. If the applicant can receive the retirement funds only by borrowing them, or upon retirement or termination of

### **Example—Calculating Cash Value of an Asset**

Mr. Smith has \$10,000 in an IRA account. The account's market value is \$10,000. To withdraw funds from the account, Mr. Smith must both pay a withdrawal penalty and taxes on the amount withdrawn.

The cash value of the IRA account is:

Market value		\$10,000
Withdrawal penalty	<i>less</i>	200
Tax	<i>less</i>	2,000
Cash Value		\$7,800

employment, the funds are not counted as assets for determining income. If the applicant can withdraw retirement funds without retiring or terminating employment, the funds are counted as assets, even though penalties may apply.

#### **D. Calculating Income from Assets**

For the purpose of computing annual income, the assets of all household members are considered. In addition, if any household member has disposed of assets for less than fair market value during the two years preceding the effective date of certification or recertification, the asset must be considered when calculating income from assets for annual income.

##### ***1. Two Methods for Calculating Income from Assets***

Two different methods of calculating income from assets are used, depending upon the total cash value of household assets:

If the cash value of total assets is \$5,000 or less, the amount of asset income included in annual income is the actual income to be derived from these assets.

If the cash value of total assets is more than \$5,000, the amount of asset income included in annual income is the greater of (1) the actual income to be derived from the assets; or (2) an imputed income from assets that is calculated by multiplying the total cash value of assets by the current HUD rate, which can be found in the HUD 4350.3 Occupancy Handbook, Chapter 5, available at <http://www.hudclips.gov>. Generally, the imputed income from assets is larger than the actual income to be derived from the assets when an applicant owns nonincome-producing assets of significant value.

##### **Example—Income from Assets for Annual Income Calculation**

Charles and Patty Brown, both age 40, have applied for a Section 515 unit. The Brown family has the following assets.

A certificate of deposit of \$6,800 they have been saving for a down payment. It earned 6.8 percent or \$462 of interest last year. Estimated cash value after paying penalties is \$6,500.

A savings account of \$4,000 earning four percent interest annually.

The six-month balance in the checking account is \$300 (noninterest-bearing account).

The cash value of the Browns' assets is \$10,800 (\$6,500 + \$4,000 + \$300). However, the Browns will be required to use \$3,300 toward the purchase of a car so that Charles may get to work. Therefore, the cash value of assets to be counted toward income from assets is \$7,500. The cash value of the remaining assets is more than \$5,000. To compute income from assets, use the greater of actual income or imputed income.

	<b>Cash Value</b>	<b>Actual Income Earned</b>	<b>Imputed Income</b>
Checking Account	\$300	\$0	<b>\$150 (\$7,500 x 0.02)</b>
Certificate of Deposit	\$6,500	\$442 (\$6,500 x 0.068)	
Savings (\$4,000 - \$3,300 down payment)	\$700	\$28 (\$700 x 0.04)	
<b>Total</b>	<b>\$7,500</b>	<b>\$470</b>	

## 2. *Assets Disposed of for Less than Fair Market Value*

Applicants who dispose of assets for less than fair market value have, in essence, voluntarily reduced their ability to afford housing. Therefore, assets disposed of for less than fair market value during the two years preceding a determination of annual income must be used in the annual income calculation. Assets disposed of for less than fair market value as a result of foreclosure, bankruptcy, divorce, or separation are not included in this calculation.

The amount of income to be included in annual income is the difference between the market value of the asset and the amount that was actually received (if any) in the disposition of the asset.

### **Example—Valuing a Disposed Asset**

An applicant sold a property to a relative for \$15,000 on July 1, 1996. The property was valued at \$30,000 and had no loans against it.

Market value	\$30,000
(Less) Settlement costs	\$2,000
(Less) Sales price	<u>\$15,000</u>
Cash value	\$13,000

The \$13,000 would be counted as an asset for any annual income determination conducted until July 1, 1998. Even though there would be no actual income from this asset, the \$13,000 would be used to establish total assets to determine the amount to be counted as annual income.

## 6.10 CERTIFICATION AND VERIFICATION PROCEDURES

Each applicant must provide the income, expense, and household information needed to enable the borrower to make income determinations. Most of this information should be provided on the application, but some additional follow-up with the applicant may be required. The borrower must verify information provided by the applicant prior to admission.

### **A. Certification Procedures**

The borrower is not required to complete a tenant certification for every applicant that applies for occupancy at the property, only for those who will likely be placed in a unit when it becomes vacant. When it becomes necessary to certify an applicant for admission to the property, the borrower and the applicant will complete *Form RD 3560-8*. Using the information submitted by the applicant during the application process and any additional information that needs to be updated at the time of certification, the borrower will use the *Form RD 3560-8* to calculate annual income and adjusted income and finally the tenant rent payment (in accordance with Chapter 7).

In projects that are receiving assistance from other sources that are also required to certify tenant incomes, the Agency may agree to accept an alternate agency's certification documentation, if it provides the same level of information as required by the Agency.

### **B. Verification Requirements**

Verification of employment income, as well as any household income from sources other than employment, must be verified by the borrower prior to submission of *Form RD 3560-8* to the Agency. Each applicant must sign a request for verification of

employment at the time of application. Copies of this form must accompany any request for verification from third-party sources. Written verifications provided by third-party sources or documents prepared by third-party sources are generally preferred. Oral verifications, if accepted, must be documented carefully.

Written income-related verifications are valid for 90 days and may be valid for an additional 90 days with oral reverification at the end of the 90-day period. In no case may information that is older than 180 days be used.

When it is not immediately possible to obtain the written verification from the income source, the income may be temporarily verified by actually examining the income checks, check stubs, or other reliable data the person possesses which indicates gross income. Income verification is required for tenants of Off-Farm Labor Housing—domestic laborers including migrant farmworkers. Income verification is not required for tenants of On-Farm Labor Housing.

Farm labor employment verification is required for all domestic farm laborers, whether they are year-round, seasonal, or migrant farmworkers, or farmworkers living in On-Farm Labor Housing.

Third-party verification of income and employment, as applicable, is required whenever it is possible or available.

When third-party verification of income and employment is not possible or available, the applicant or tenant may provide the borrower with an award and benefit letter, cost of living adjustment notice, benefit statement, bank statement, or actual benefit check. Using this documentation, the borrower may “self-certify” the farmworker’s application using any available documents or records the applicant may have or information the applicant can provide. In the absence of available income and employment records, the borrower may forecast income expected to be received by the tenant during occupancy for determining eligibility and rental assistance.

### **C. Verification Procedure**

The borrower must establish a verification procedure to review applicant information. The procedure must ensure accurate determinations of eligibility and respect the confidentiality of all information on applicants and residents.

#### ***1. Information to Verify***

The borrower must verify the following information:

- **Disability:** Disabilities are verified only if necessary to qualify the household as an elderly family, or if a disability affects the household's eligibility for deductions from income. Verification may be provided by a physician, a clinic, welfare agency, the Social Security Administration, or other knowledgeable service.
- **Household composition:** Verification of household composition can be accomplished through a variety of sources and documents. For example, a birth

certificate or custody agreement verifies that a minor child is part of the household. Also, divorce or separation agreements can verify that an individual is no longer a member of the household.

- **Income:** Procedures for verifying income are described below in Exhibit 6-3.
- **Citizenship status:** Proper documentation of citizenship is discussed in Section 6.4. If the tenant indicated being an alien, the borrower must verify tenant's status with the DHS. The tenant must sign a declaration indicating status, and whether or not status has changed, on an annual basis.

### Exhibit 6-3

#### Income Verification Requirements and Procedures

- **Income Tax Return:** A complete, legible copy of the most recently filed Federal income tax form must be submitted for each applicant, unless the person was exempted from filing a return.
- **Verification of Employment:** After the applicant submits a form verifying employment, the Agency must send this form to each employer for verification of employment of each household member.
- **Self-Employed Persons:** Self-employed applicants must provide current documentation of income and expenses, which cannot be older than the previous fiscal year. The Agency must compare the income and expenses information provided by the applicant with the latest income tax return and clarify any discrepancies.
- **Unemployment and Unemployment Benefits:** Unemployed applicants must complete a form, which provides their current employment status and requires them to agree to inform the Agency immediately, in writing, if their employment status changes. Applicants receiving unemployment benefits must provide the most recent award or benefit letter prepared and signed by the authorizing agency to verify the unemployment income.
- **Regular, Unearned Income (e.g., Social Security, pensions, workers compensation):** Applicants must provide a copy of the most recent award or benefit letter prepared and signed by the authorizing agency. Information must be updated every 12 months to account for cost-of-living increases or changes in benefits.
- **Public Assistance:** Applicants must provide a copy of the most recent award or benefits letter prepared and signed by the authorizing agency to verify the amount of public assistance received.
- **Alimony or Child Support Payments:** The applicant must provide a copy of the divorce decree, separation agreement, or other document indicating the amount of the required support payments. The applicant must also report the amount received during the past twelve months. If the applicant reports that the amount required by the agreement is not being received, the applicant must document that assistance has been requested from the state or local entity responsible for enforcing payment.
- **Support for Foster Children or Adults:** Payments received for the care of foster children or foster adults may be considered when calculating repayment income. Documentation must be provided indicating the amount of money received for the care of foster children or adults, and the anticipated period of time the support will be provided.
- **Verification of Assets and Income from Assets:** The Agency requests that financial institutions verify account balances. For some assets such as mutual funds or 401(k) accounts, copies of year-end statements can provide information about annual income. Applicants must certify whether any asset has been disposed of for less than fair market value.



## ***2. Release and Consent Form***

A form verifying employment (developed by the borrower) gives applicant or resident permission for the borrower to ask questions about and verify information related to the household income and other circumstances that affect eligibility and the amount the household must pay. Applicants must sign the form as a condition of admission and continued occupancy.

The form must be signed by the household head and all other household members whose income, assets, or other circumstances require verification. As long as the borrower retains the form with original signatures in its file, a photocopy of the authorization may be provided to verification sources.

The borrower must ask applicants/residents to execute the form even in cases where the person has not reported any income.

## ***3. Social Security Numbers***

Prospective tenants must provide the borrower with Social Security Numbers for every tenant or co-tenant in the household. The borrower may use Social Security Numbers to verify income information that is provided. Social Security Numbers must be verified only once for each resident.

Documentation of the Social Security Number will be provided with a valid Social Security card or other evidence of the Social Security Number, such as a driver's license. If the documentation is sent by mail, the applicant may submit a photocopy.

If the applicant does not have the documentation, the applicant should submit a signed certification stating his/her Social Security Number. The applicant then has 60 days to submit acceptable documentation of the Social Security Number. This 60-day period can be extended for another 60 days for elderly applicants.

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## SECTION 3: OCCUPANCY POLICIES AND OCCUPANCY RULES [7 CFR 3560.157]

### 6.11 OCCUPANCY POLICIES

The purpose of the occupancy policy in a multi-family property is to establish:

- Unit density standards; and
- Procedures for assigning units.

#### A. Unit Density Standards

Occupancy policies set standards regarding the number of people that can be adequately housed in a unit of a particular size. In developing the occupancy policy for each unit, the borrower must take into account the following:

- State and local codes regarding the number of persons permitted to dwell in a unit of a particular size;
- The size of the rooms in the particular unit;
- Procedures for sizing households for different unit types (how to consider temporarily absent household members); and
- The order in which the property will house eligible applicants and rehouse existing tenants.
- A tenant who is disabled will not be considered overhoused if the tenant needs an additional room for a live-in aide or an apparatus related to the tenant's disability.

For some properties, state and local codes regarding occupancy standards may not exist. In these cases, the borrower should make a judgment as to how many people may be adequately housed, basing it on the square foot size and layout of the unit. For example, some properties may have several types of two-bedroom units. If one is 600 square feet and the second type is 900 square feet, the borrower may have different occupancy policies for the different unit types. An example of what an occupancy policy might look like for the above example is detailed below:

Unit Type	Minimum Density	Maximum Density
2 Bedroom (600 sq. feet)	1 person	3 persons
2 Bedroom (900 sq. feet)	2 persons	4 persons

The following is an ideal range of persons per housing unit:

Number of Bedrooms	Occupancy Density Range	
	Minimum	Maximum
0	1	1
1	1	2
2	2	4
3	3	6
4	4	8
5	5	10

A borrower with a project that has no one-bedroom units may make an exception to the minimum threshold requirement.

### **B. Procedures for Assigning Units**

Occupancy policies also establish the order in which eligible applicants and existing tenants will be housed or rehoused.

Borrowers are required to comply with Section 5 of this chapter in selecting and assigning applicants to new units or relocating over- or underhoused existing tenants. However, it is important that these requirements are detailed in the borrower's occupancy policies, so that it is clear to new applicants and existing tenants how a vacant unit will be assigned.

## **6.12 AGENCY REVIEW AND MONITORING OF OCCUPANCY POLICIES**

The Agency must concur with the borrower's occupancy policies prior to initial occupancy of the project and in all future modifications. In reviewing the policies, the Agency must assure that the standards are in compliance with state and local laws and that they appear reasonable based on the unit size and type. The Agency should review compliance with the policies during the compliance review. If a household is residing in the property and is out of compliance with the occupancy policy, the borrower must follow procedures outlined in Paragraph 6.29 for tenants in violation of occupancy rules.

## **6.13 OCCUPANCY RULES**

The purpose of the occupancy rules is to establish the basis for the tenant and management relationship.

### **A. Basic Rules**

Exhibit 6-4 lists the basic items that borrowers must address in the occupancy rules for their projects.

Occupancy rules for each project will be in writing, attached to each tenant's lease upon initial occupancy, and posted in a central location (such as a central mail location)

so that tenants may easily access the information. Modifications to these rules will be provided to the tenant at least 30 days prior to implementation and in accordance with the requirements of Section 8 of this chapter.

## **B. Pets**

For each multi-family housing project or portion of a project specifically designated for the elderly, the borrower must have established project rules permitting elderly or disabled tenants to keep commonly accepted household pets.

Pet rules must not:

- Prohibit, prevent, restrict, or discriminate against any tenant who owns or keeps a pet in their apartment unit, with respect to continued occupancy in the project unless the approved project pet rules are violated;
- Prohibit, prevent, restrict, or discriminate against any applicant who owns a pet with respect to obtaining occupancy in the project; and
- Charge an extra monthly rental charge for pets.

Borrowers with operational projects must consult with the tenants of the project when revising pet rules and retain documentation on how the consultation process was conducted.

Borrowers with new projects will establish pet rules prior to occupancy, but may revise those rules based on tenant comments and suggestions received after rent-up begins.

Pet rules will be approved by the Agency as part of, or as an amendment to, the project lease. Agency approval will be granted when the rules meet the provisions and intent of this subparagraph.

Pet rules will be reasonable and will be written to consider at least the following factors:

- Density of project units;
- Pet size;
- Type of pet;
- Potential financial obligations of tenants who own or keep pets;
- Standards of pet care;
- Pet exercise areas;

- State and local animal laws or ordinances; and
- Liability insurance.

Pet rules must allow the borrower or project manager authorization to remove from the project any pet whose conduct or condition is duly determined to constitute a nuisance or threat to the health or safety of other tenants or members in the project or persons in the surrounding community.

**Exhibit 6-4**

**Required Items for Multi-Family Housing Occupancy Rules**

At minimum, the occupancy rules should include:

- An explanation of the tenant's rights and responsibilities under the lease or occupancy agreement;
- The rent payment or occupancy charge policies;
- The policies regarding periodic inspection of units;
- The system for responding to tenant complaints;
- The maintenance request and work-order procedures;
- The project services and facilities available to tenants or members;
- The office locations, hours, and emergency telephone numbers;
- The restrictions on storage and prohibitions on abandoning vehicles in the project area;
- The way to obtain community and public transportation schedules;
- The policies regarding guests that become household members;
- Other requirements related to the subsidy provided to the tenant from non-Agency sources; and
- The procedures tenants must follow to request reasonable accommodations.

Regardless of the occupancy rules established for the project, the borrower must adhere to the following:

- Borrowers must not prohibit elderly households from keeping domestic animals in their unit; and
- Borrowers must not prohibit animals that provide assistance to the handicapped or disabled from residing in the unit with the person to whom the animal is providing assistance.

However, the borrower may require the household to pay a pet deposit in these situations.

### **C. Tenant Organizations**

In developing and implementing the occupancy rules, borrowers must not infringe on the rights of tenants to organize an association of tenants. The project manager (or designated management representative) should be available and willing to work with a tenant organization.

Borrowers may not unreasonably withhold the use of community rooms or other available space within the project when requested by:

- A resident organization in connection with the representational functions of the organization; or
- Residents seeking to organize or to collectively consider any matter pertaining to the operation of the project.

### **D. Community Rooms**

In developing the occupancy rules, borrowers must not place unreasonable restrictions on tenants that desire to use Federally financed community rooms for their enjoyment. While a schedule of fees may be developed for the use of the community space, fees should be reasonable and meant only to cover the costs of cleaning and maintenance of the facility being used.

## **6.14 AGENCY REVIEW AND MONITORING OF OCCUPANCY RULES**

Borrowers must obtain concurrence from the Agency prior to the implementation of the occupancy rules, and must obtain Agency concurrence before making any modifications to the rules.

If tenants believe the borrower is in violation of occupancy rules, they must be directed to follow the procedures outlined in Section 8 of this chapter.

The Loan Servicer will review compliance with the occupancy rules during the compliance review. In a situation where the Loan Servicer believes management is in violation of the occupancy rules, the Agency must state the violation as a finding and require the borrower to resolve the problem in a specified time frame.

In situations where the tenant is in violation of the occupancy rules and the tenant fails to correct the problem, the borrower should proceed to evict the tenant for material noncompliance with the lease. In the event that an eviction action is filed with the court, the borrower is required to set up an escrow account for the rent paid by the tenant. Borrowers are required to continue to collect rent during eviction proceedings.

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## **SECTION 4: MARKETING AND APPLICATION PROCESSING** **[7 CFR 3560.104 and 7 CFR 3560.154]**

### **6.15 REQUIREMENTS FOR AFFIRMATIVE FAIR HOUSING MARKETING PLANS**

Borrowers with four or more units are required to prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) using *Form HUD 935.2, Affirmative Fair Housing Marketing Plan*. The purpose of this plan is to set forth how the borrower will meet their Fair Housing responsibilities. This plan will be submitted to the Agency for approval prior to loan closing. The Agency may also require periodic modifications to the plan if implementation is not reaching the population groups targeted by the plan. At a minimum, the AFHMP will address the following:

- Outreach efforts of the property;
- Marketing strategies; and
- Education and training of all staff on Civil Rights laws (e.g., Title VI, Fair Housing, Section 504, Title IX).

The approved plan must be posted by the borrower in a prominent location for public inspection. This could include the project site, the rental office, or other location where applications are received for the property.

The borrower must develop and maintain a system for conducting self-assessments of the property staff's performance in implementing an approved AFHMP.

### **6.16 APPLICATION REQUIREMENTS AND PROCESSING**

The purpose of the tenant application process is to collect enough information regarding the household status to determine applicant eligibility for the specific property. This information should also be comprehensive enough for the borrower to make a determination about waiting list placement.

#### **A. Application Forms**

Borrowers may develop their own application form in accordance with the requirements of Exhibit 6-5. The borrower must retain application forms for at least three years or until the next compliance review is conducted by the Agency.

**Exhibit 6-5****Minimum Requirements for a Tenant Application**

- Name and present address;
- Household income information, including all information from sources that would be counted in calculating annual income (see Section 6.3 of this chapter), adjusted income, and net assets;
- Number of household members, including all members who would live in the dwelling unit, even those who would only live there on a part-time basis, and their birthdates;
- Indication of a need for a handicap accessible unit and/or handicap or disability adjustments to income;
- Applicant certification that the unit will serve as the household's primary residence;
- Social Security Number for tenant and co-tenant;
- Adjustments to income for which the household may qualify, which should be verified in accordance with Paragraph 6.9;
- Signature and date;
- Race, ethnicity, and gender designation; and
- Disclosure notice.

Recipients using application forms must establish a section at the end of the form, below the signature and date block, to collect race/national origin/gender information. In addition, the following disclosure notice must be included:

The information regarding race, ethnicity, and sex designation solicited on this application is requested in order to assure the Federal Government, acting through the Rural Housing Service, that the Federal laws prohibiting discrimination against tenant applications on the basis of race, color, national origin, religion, sex, familial status, age, and disability are complied with. You are not required to furnish this information, but are encouraged to do so. This information will not be used in evaluating your application or to discriminate against you in any way. However, if you choose not to furnish it, the owner is required to note the race, ethnicity, and sex of individual applicants on the basis of visual observation or surname.

Please identify your ethnicity, race, and sex as follows:

- 1 - American Indian or Alaskan Native
- 2 - Asian
- 3 - Black or African American
- 4 - Native Hawaiian or Pacific Islander
- 5 - White

Choices for Ethnicity are:

- a - Hispanic/Latino
- b - Non-Hispanic Latino

The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form available in the Servicing Office.

Borrowers must establish and maintain a specific place and time where applications will be accepted. This information should be posted in a central location on the property. It must also be documented in the Management Plan and the AFHMP and to the greatest extent possible communicated through outreach and marketing efforts.

Applicants are to be provided a list of any additional information that must be submitted with the application for the application to be considered complete (an application will be considered complete without verification of the applicant information). The list of information must be restricted to the same items for all Agency-assisted properties of a particular type, such as a family or elderly complex.

## **B. Maintaining Waiting Lists**

When an applicant submits an application form, the borrower must notify the applicant in writing that they have been selected. All completed applications must be placed on the list. The waiting list may be maintained in an electronic or manual format. The waiting list will document the final disposition of all applications (rejected, withdrawn, or placed in a unit).

### ***1. Incomplete Applications***

If an applicant submits an incomplete application, they must be notified in writing within 10 calendar days of the items needed for the application to be considered complete and that priority will not be established until the additional items are received.

### ***2. Electronic Waiting Lists***

Electronic waiting lists must have a mechanism for maintaining the date and time of each applicant's placement on or selection from the waiting list and a way to document changes made to the list. The following are examples of methods that borrowers might use to track inputs to the electronic waiting list and changes to it:

- Use a data backup function to record the time and date of entry of new applications and changes to existing records in the electronic waiting list.
- Print a record of the appearance of the waiting list as often as necessary (at least monthly) to show each applicant's placement on and selection from the list. The time

and the date of the printout should appear on the report. The owner can file this information in the tenant file and in a central waiting list file.

- Whenever status changes occur, such as changes in family composition and unit size, record the change with an explanation, and print the re-sorted list.

To the extent possible, the borrower should use electronic safeguards, such as assigning waiting list password access only to individuals responsible for maintaining the system. Ideally, a system should record the user name and the time, date, and action entered whenever a record is changed or entered in the electronic waiting list.

### ***3. Selecting Applications from the Waiting List***

Once an applicant has submitted a complete application and signed a form verifying employment (developed by the borrower), the date and time must be recorded on the waiting list to establish priority for selection. Selection from the waiting list will be made according to date and time in the following order:

- Very low-income applicants;
- Low-income applicants; and
- Moderate-income applicants.

See Paragraph 6.3 for information regarding how to determine the specific income level of an applicant.

Within 10 calendar days of receipt of a complete application, the borrower must notify the applicant in writing that he has been selected for immediate occupancy, placed on a waiting list, or rejected.

The procedures used by the borrower to purge the project's waiting list must be described in the project's management plan. These procedures must be based on the length of the waiting list or the extent of time the applicant will be expected to wait for housing.

## **6.17 REJECTION OF APPLICATIONS**

Borrowers may deny admission for criminal activity or alcohol abuse by household members.

Borrowers are required to notify all applicants in writing of their ineligibility. If applicants are determined to be ineligible, the rejection letter must outline the reason for rejection of the application and their right to appeal such a decision in accordance with 7 CFR 3560.154. The rejection letter must advise the applicants of their right to appeal the decision within 10 calendar days, as well as the right to a hearing. If the project is located in an area with a high concentration of non-English-speaking individuals, the letter must be in English and the non-English language that is prevalent in the area. When an applicant is rejected due to

credit bureau reporting information, the source of the credit bureau must be revealed to the applicant in accordance with the Fair Credit Reporting Act.

## **6.18 AGENCY REVIEW AND MONITORING OF APPLICATION PROCESSING**

In reviewing the application process employed by the borrower, the Agency should review the following:

- Is adequate documentation available to determine compliance with applicant processing requirements?
- Are applicants properly informed of where and when applications may be obtained and submitted?
- Does the application provide the borrower with adequate information to determine the applicant's place on the waiting list?
- Is there an element in the application process that discourages targeted populations from submitting an application? If so, will modifying the application process encourage targeted, but underserved populations to apply?
- Are applications processed in a timely manner?
- Are ineligible applicants adequately notified of their appeal rights under Section 8 of this chapter?

Loan Servicers should review the application during the compliance review to ensure that adequate information is being obtained and that the above-listed questions are answered to the satisfaction of the Agency.

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## **SECTION 5: TENANT SELECTION AND UNIT ASSIGNMENT**

### ***[7 CFR 3560.154 AND 7 CFR 3560.155]***

#### **6.19 ASSIGNING AN AVAILABLE UNIT**

Once a unit becomes available, the borrower must decide who is entitled to that unit based on a variety of factors.

Eligible tenants residing in the property who are either under- or overhoused receive priority over new applicants if relocating them into the newly vacant unit would bring the household into compliance with the occupancy policy for the property. If there are no such over- or underhoused existing tenants, the borrower must select a new applicant from the waiting list to fill the newly vacant unit. The borrower must use the project's occupancy policy to look at applicants on the waiting list who are eligible based on the unit size. From that universe, the borrower must then determine, based on income levels and priorities, which applicant is entitled to the unit. The order in which applicant households are entitled to housing depends on two factors:

- The income level of the household; and
- The priorities for which the household may qualify.

When an applicant first submitted an application, the borrower made an initial determination as to whether the household was very low-, low-, or moderate-income. Based on this assessment, the applicant was assigned to the very low-, low-, or moderate-income waiting list. When looking for the next eligible tenant for the vacant unit, the borrower must first go to the very-low income waiting list. If there are no applicants on the very low-income waiting list who qualify for the vacant unit based on the property's occupancy policy, then the borrower may go to the low-income waiting list. Only if there are no eligible applicants for the unit on the low-income waiting list may the borrower select an eligible applicant from the moderate-income waiting list.

#### **6.20 PRIORITIES FOR UNITS**

##### **A. Exceptions to Income Standard Assignment Policies**

While the basic standard is to house all very low-income applicants prior to low- and then moderate-income applicants, there are two situations where this process could be bypassed:

- If the unit is a handicapped accessible unit, then an eligible household that needs the features of that unit will receive priority over all other applicants, regardless of income. If more than one applicant needs the features of the handicapped accessible unit, then applicants who are very low-income would have priority, followed by low- and then moderate-income households.

- In congregate housing facilities, applicants who qualify for and agree to utilize the services provided by the facility will be housed over all other applicants on the waiting list. Where there is more than one applicant that meets this criterion, the applicants meeting this condition will be ranked by very low-, low-, and moderate-income and housed in accordance with the occupancy policies established at the property.
- Borrowers with projects receiving low-income housing tax credits (LIHTCs), may leave a housing unit vacant if they are required to rent the available unit to an LIHTC-eligible applicant, and none of the applicants on the waiting list meet the applicable LIHTC eligibility requirements.

#### **Example— Exceptions**

Project B has two handicap-accessible units. There are three handicapped individuals who need the features of the handicap-accessible units on the waiting list: one moderate income and two low-income. The property has a waiting list of 20 very low-income applicants. The borrower must rent the two handicap-accessible units to the two low-income applicants.

Project Z is a congregate housing facility and has a vacant one-bedroom unit. There are three individuals eligible for a one-bedroom unit on the waiting list: two very low-income applicants and one low-income applicant. All qualify for congregate care services. Only one of the very low-income applicants, however, would agree to use the congregate care facilities. The borrower would have to offer one of the vacant units to the very low-income applicant who agrees to use the services and the other unit to the low-income applicant who agrees to use the services.

Holders of *Handbook Letter 201 (3560)*, *Letter of Priority Entitlement (LOPE)*, persons displaced by Agency action, or displaced persons in a Federally declared disaster area have priority over all other applicants of the individual applicant's income group. However, an individual in one of these three categories would not be eligible for housing before applicants on the waiting list for a lower income category.

#### **Example**

Project C has a vacant three-bedroom apartment. There are no applicants eligible for a three-bedroom unit on the very low-income waiting list. There are 20 applicants eligible for a three-bedroom unit on the low-income waiting list. A holder of a LOPE applies for occupancy at the project. The applicant is low-income and qualifies for a two-bedroom unit. Despite the number of applicants on the waiting list, the borrower must offer the available unit to the LOPE holder, and the LOPE holder agrees to move to the appropriate-size unit when one becomes available.



## **B. Assignment of Rental Units Accessible to Individuals with Disabilities**

If a rental unit accessible to individuals with disabilities is available and there are no applicants that require the features of the unit, the borrower may rent the unit to a nondisabled tenant under the following conditions:

- The borrower must include a provision in the lease requiring the tenant to vacate the unit within 30 days of notification from management that an eligible individual with disabilities requires the unit;
- The unit has been marketed as an accessible unit;
- Outreach has been made to organizations representing the disabled; and
- Marketing of the unit as an accessible unit continues after it is rented to a tenant who is not in need of the special design features.

Borrowers receiving HUD Section 8 project-based assistance may establish preferences in accordance with HUD regulations. The use of such preferences must be documented in the project's management plan.

### **6.21 AGENCY MONITORING AND REVIEW OF UNIT ASSIGNMENT**

The selection and assignment of units is one of the most important aspects to managing a property. Borrowers and management agents must assure onsite management staff are well versed in Agency policy and guidance regarding this subject or require the borrower to modify the management plan to reflect increased training in this area. The Loan Servicers will review the waiting lists and completed applications to ensure that:

- Units which are not needed to rehouse existing tenants are first offered to eligible very low-income families; and
- Units are offered to households in accordance with the borrower's occupancy policy.

If Loan Servicers find that the borrower or the agent is failing to follow Agency policy in assigning available units, Loan Servicers may require the borrower modify the management plan to clearly reflect Agency policy and/or enhance the training of management staff responsible for assigning units.

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## **SECTION 6: DWELLING LEASES [7 CFR 3560.156]**

### **6.22 OVERVIEW OF DWELLING LEASES**

A lease between the borrower and the tenant is required to be executed before any tenant occupies a unit in a multi-family housing project. This section will provide information regarding how the borrower will develop that lease and what action is needed by the Agency before the lease may be used. The Agency must approve the lease before the borrower enters into a lease agreement with any tenant.

### **6.23 DEVELOPMENT OF A LEASE**

The borrower is responsible for the development of the tenant lease that will be used at the property. This lease must contain the required items, provisions and clauses outlined in **Attachment 6-B** and must be free of prohibited clauses listed in **Attachment 6-C**. It must also be in compliance with state and local laws. If there are conflicting requirements between Federal, state, and local laws, the borrower must notify the Agency of the conflict and request guidance. Once a lease is developed by the borrower, the borrower's attorney must certify that the lease is in compliance with the requirements of 7 CFR 3560.156 and **Attachments 6-B** and **6-C** prior to submission of the lease to the Agency for approval. The Agency must concur with all leases proposed for use at an Agency-related property, prior to the use of that lease.

### **6.24 EXECUTION OF THE LEASE WITH THE TENANT**

Prior to the occupancy of any unit by an applicant, the applicant and the borrower must execute a lease that has been approved by the Agency. Once a lease has been executed with the applicant, they are entitled to occupy the unit so long as they remain eligible and comply with lease renewal requirements. Expiration of the lease is not of itself grounds for a termination of tenancy.

### **6.25 AGENCY REVIEW AND MONITORING OF LEASE REQUIREMENTS**

The management agent must review and monitor the implementation of the lease with the applicant/tenant to ensure that they are properly informed of their rights and responsibilities under the lease. During the compliance review process, the Agency should look to assure:

- The occupancy rules are attached to the initial lease;
- The applicant understands their rights to the tenant grievance process under HUD Section 8 and 7 CFR 3560.160; and
- The applicant understands the process for relaying information such as maintenance requests and income information to management and the responsibility to do so in a timely manner.

If the Loan Servicer finds the borrower is failing to provide adequate information regarding the rights and responsibilities of the tenant and the management agent, the Loan Servicers should require the borrower to improve the management plan and training of onsite staff.

## **SECTION 7: TENANT RECERTIFICATION AND CHANGES IN ELIGIBILITY [7 CFR 3560.152 and 7 CFR 3560.158]**

The recertification process developed in this section is designed to ensure a tenant remains eligible to reside in multi-family housing. As household status changes, the size of the unit needed by the household or the amount of rent that they are obligated to pay may change. This section discusses when a recertification is required and what action the borrower will be required to take if a household is determined ineligible to continue residing at the property.

### **6.26 REQUIREMENTS TO RECERTIFY TENANTS**

#### **A. The Annual Recertification Process**

Each time a resident is recertified, the certification is good for one year, unless subpart 2 of this paragraph requires a recertification to be completed more frequently. At the end of the year the certification will expire and the borrower is required to recertify the household. The tenant's recertification date is the first day of the month for which the tenant is eligible to receive subsidy. Using the procedures outlined in Section 1 of this chapter, the borrower will complete a new certification. The key steps to this process include:

##### ***1. Notifying the Tenant of the Recertification Requirement***

At least 75 to 90 days prior to the date that the certification expires, the borrower must notify the tenant in writing that they must be recertified to remain eligible to continue residence at the property. This letter will also include what information the borrower needs from the household in order to complete the certification.

If the household still fails to respond to the letter, the borrower should issue a second letter 30 days prior to the date which the certification expires informing the tenant of the:

- Information needed to recertify;
- The time frame in which the new certification must be submitted to the Agency; and
- The consequences for failure to comply with the recertification process.

##### ***2. Execution of the New Certification***

Upon receiving the information regarding household size and income from the tenant, the borrower will verify the information and the borrower and the tenant will complete a new *Form RD 3560-8*. This form will document the calculation of annual income and adjusted income (in accordance with Section 1 of this chapter) and the calculation of the tenant payment (in accordance with Chapters 7 and 8).

## **B. Interim Recertification Process**

If a tenant reports that the household's adjusted gross income has decreased, and the determination is made that the household has an adjusted gross income of zero, the owner must immediately reexamine the household. The owner is required to reexamine the household's income three months from the previous zero income reexamination unless the household has voluntarily notified the owner of a positive change in income during the interim and a subsequent reexamination has been prepared.

Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of \$100 or more per month occurs. Borrowers must recertify for changes with of \$50 per month, if the tenant requests that such a change be made.

### ***1. Tenant Requirements***

- Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.
- Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.
- Tenants must report all changes in household status that may affect their eligibility to borrowers.
- Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in 7 CFR part 3560, subpart O.

### ***2. Borrower Requirements***

- Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.
- Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or net tenant contribution.
- Borrowers must submit initial or updated tenant certification forms to the Agency within 10 days of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a first day of the month.
- Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents,

borrowers who fail to submit annual or updated tenant certification forms within the time period specified in Paragraph 6.27 B of this section will be charged overage, as specified in 7 CFR 3560 203(c). Unauthorized assistance, if any, will be handled in accordance with 7 CFR part 3560, subpart O.

- Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.
- Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer.
- The Agency maintains the right to independently verify tenant eligibility information.

### **C. Submission of the Certification to the Agency**

Once the borrower and the tenant execute a certification, it must be submitted to the Agency within 10 days of the effective date of the certification. In order for a certification to be valid, it must be signed and dated by all parties on or before the effective date and maintained in the tenant file. If a borrower fails to submit a certification by the effective date, it will result in monetary penalties to the borrower as established in Chapter 7.

## **6.27 AGENCY REVIEW AND MONITORING OF THE RECERTIFICATION PROCESS**

### **A. Agency Review**

The recertification process is designed to ensure that Agency programs are serving income-eligible households on an ongoing basis. Loan Servicers review of the recertification process should be designed to ensure that recertifications are executed in a timely manner. The Loan Servicers should make the following assessments:

- Are tenants receiving the proper notice—at least 90 days in advance of the expiration of the current certification?
- Does the notice provide the tenant with a list of the information needed for the completion of the recertification process?
- Are borrowers accurately determining when an interim recertification is needed?
- Are interim recertifications being executed on a timely basis (i.e., no later than 30 days from the time the information is provided to the borrower)?
- Does the certification form provide the information needed by the Agency to determine that the tenant payment and rental subsidy have been calculated correctly?
- Is the borrower completing the verification of information on a timely basis?

If the Loan Servicer concludes that the borrower is deficient in recertifying existing tenants, the Agency must require the borrower and the management agent to modify existing practices and procedures to ensure a more timely delivery of recertifications to the Agency. This could include:

- Modification of the management plan to incorporate stronger or more specific procedures with regard to recertifications;
- Enhanced training for onsite staff in processing Agency certifications; and
- Stronger enforcement of the penalties for tenants who fail to comply with the recertification process.

#### **B. Management Agent Interactive Network Connection (MINC)**

MINC is the mechanism by which borrowers submit tenant certifications to the Agency electronically on a monthly basis.

Within twelve months of the date of publication of the final regulation, for projects with eight units or more, all borrowers will be required to submit tenant certifications through MINC. The Agency may make an exception to this requirement if the borrower submits documentation that the costs associated with electronic submission of tenant certifications would pose a financial hardship to the project.

If the borrower is using MINC, certifications must be submitted by the tenth of the month for which they are due. For instance, if the borrower is submitting certification due in May with an effective date of May 1, the certifications must be electronically transmitted to the Agency between May 1 and May 10. If for any reason the borrower is unable to transmit the certifications electronically during a given month, the borrower must submit the hard copies of the certifications to the Agency for receipt by the tenth of the month.

Borrowers who are not using MINC must either submit certifications on a diskette or hard copies to the Agency for receipt by the tenth of the month.

Regardless of the transmission method used—MINC, diskettes, or hard copies—if the Agency does not receive certifications by the tenth of the month in which they are due and the borrower has not notified the Agency that the transmission will be late, the borrower will be subject to overage penalty.

**Attachment 6-D** provides guidance on the allowable sources of funds for obtaining automation capabilities.



## 6.28 INELIGIBLE TENANTS

Ineligible tenants are those who, upon recertification, fail to meet either the income or the occupancy requirements for the unit and property that they currently occupy. Regulations require that tenants who are no longer eligible to reside at the property be given notice that they must vacate the property within 30 days or at the end of their lease, whichever is longer.

### **A. Continuation of Tenancy—Tenants Who Fail to Comply with the Occupancy Policy**

In some situations, a tenant may be ineligible based on the size of the unit currently occupied, but could become eligible if shifted to a unit of a different size (either larger or smaller) within the property. In this situation, a tenant may continue tenancy as an ineligible tenant, but the borrower should relocate the household to the proper unit size as soon as a unit of that size becomes available.

In some cases, a household may require a unit size that is unavailable at the property. In this situation the tenant would be considered ineligible and required to vacate the property within 30 days or at the end of their lease, whichever is longer.

### **B. Continuation of Tenancy—Tenants Who Fail to Comply with the Income Requirements for the Property**

In most cases, if tenant certifications indicate that they no longer comply with the income limits set for the property, tenants must be notified about vacating the property in 30 days or at the end of their lease, whichever is longer.

In two specific situations, borrowers may permit ineligible households to reside at the project with prior Agency approval:

- The waiting list for the specific unit type has no eligible tenants; or
- The required time period for vacating the unit would create a hardship on the household.

Elderly households with incomes above the moderate-income level may occupy projects with an Agency loan approved prior to 1968 with a loan agreement that does not restrict occupancy by income.

### **C. Cooperative Members**

Any persons who are eligible members of a cooperative will not be considered ineligible or subsequently deprived of their membership by reason of no longer meeting the income-eligibility requirements as defined in 7 CFR 3560.152.

#### **D. Remaining Household Members**

Members of a household residing in a multi-family housing project may continue to occupy the unit after the departure of the original tenant, regardless of age, provided that:

- They are eligible with respect to income;
- They were either a cotenant or member of the household, have the legal capacity to sign the lease, and are U.S. citizens or qualified aliens;
- They occupied the unit with the original tenant at the time the original tenant died or departed;
- They sign a new tenant certification establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Remaining household members that are overhoused must move to a suitably sized rental unit within 30 days of its availability. If a suitably sized unit does not exist at the property, the tenant will be required to vacate the property in accordance with Paragraph 6.30 A.

#### **E. Surviving Household Members**

Members of an elderly household residing in an elderly project may continue to occupy the unit after the death of the original tenant, regardless of age, provided that:

- They are eligible with respect to income;
- They were either a co-tenant or member of the household and have the legal capacity to sign the lease;
- They occupied the unit with the original tenant at the time the original tenant died or departed;
- They sign a new tenant certification establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Surviving household members who are overhoused may remain in the unit, but must move to a suitably sized rental unit within 30 days of its availability. If a suitably sized unit is not available, surviving household members may remain in the rental unit according to the housing project's occupancy rules as follows:

- Continued occupancy of the rental unit will not be allowed when:

- ◇ The rental unit has accessibility features for individuals with disabilities;
- ◇ The household no longer has a need for such accessibility features; and
- ◇ The housing project has a tenant application from an individual with a need for the accessibility features.
- If the housing project does not have a tenant application from an individual with a need for the accessibility features, the household may remain in the rental unit until the housing project receives an application from an individual in need of the accessibility features, at which point, the household will be required to move within 30 days; and
- If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until a unit becomes available, and must then move within 30 days.

#### **F. Agency Review and Monitoring of Ineligible Tenants**

For an ineligible tenant to remain at the property beyond the allowable time frame of 30 days or the end of the lease, whichever is longer, the borrower must obtain written permission from the Agency. In granting such permission, the Agency should assure that one of two criteria exist:

- The waiting list for the specific unit type has no eligible tenants; or
- The required time period for vacating the unit would create a hardship for the household.

In reviewing whether the borrower is in compliance with the requirements to remove ineligible tenants the Agency should check to ensure:

- The borrower is requesting approval for ineligible tenants to remain on the property in a timely manner.
- The borrower is properly documenting any reason for which an ineligible tenant is being allowed to continue to reside of the property. Some of these reasons may include:
  - ◇ Permission has been granted by the Agency for the tenant to remain temporarily;
  - ◇ The tenant is a surviving member of an elderly household; or
  - ◇ The household is still income eligible and will be moved to an appropriate-size unit when one becomes available at the property.
- The borrower is providing proper notice to tenants regarding the time frames for vacating the property.

## **6.29 LEASE VIOLATIONS**

Borrowers may require tenants in violation of occupancy rules or the terms of their lease to vacate the property in accordance with the terms of their lease agreement. However, borrowers must provide notice to such tenant in a format that is in compliance with state and local laws and is approved by the Agency.

## **6.30 TERMINATION OF OCCUPANCY**

### **A. Tenants in Violation of the Lease**

In accordance with the lease, a borrower may terminate or refuse to renew a tenant's lease for material noncompliance with the lease or occupancy rules or for other good cause. Material noncompliance with lease provisions or occupancy rules includes actions such as:

- Violations of lease provisions or occupancy rules that are substantial and repeated;
- Nonpayment or repeated late payment of rent or other financial obligations due to the borrower; and
- Admission to or conviction for use, attempted use, possession, manufacture, selling, or distribution of an illegal controlled substance. Such activity must have occurred on the project's premises by the tenant, a member of the tenant household, or any other person under the tenant's control at the time of the activity.

For purposes of terminating a tenant's occupancy, good cause includes actions such as actions by the tenant or member of the tenant's household that:

- Threaten the health and safety of other persons or the right of other persons to peaceful enjoyment of their dwelling;
- Result in substantial physical damage causing an adverse financial effect on the housing or other persons' property; and
- Are actions prohibited by state or local law.

If the borrower terminates the tenant's lease, the borrower must document in writing in the tenant's file:

- The incidences related to the lease; and
- That the tenant was given notice prior to the termination that the tenant's activities would result in occupancy termination.

Prior to terminating a lease, the borrower must give the tenant written notice of the violation and give the tenant an opportunity to correct the violation. Subsequently, termination may only occur when the incidences related to the termination are

documented and there is documentation that the tenant was given notice prior to the initiation of the termination action that their activities would result in occupancy termination.

## **B. Other Lease Terminations**

A landlord may terminate occupancy for conditions beyond the tenant's control, such as:

- Required repair or rehabilitation of the building; or
- Natural disaster.

Under these circumstances, the affected tenants may request a LOPE from the Agency. The LOPE will provide the tenant with priority entitlement to rental units in other Agency-financed projects for 120 days from the date of the LOPE. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period. Tenants that are displaced due to circumstances beyond their control are entitled to benefits under the Uniform Relocation Act.

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## **SECTION 8: TENANT GRIEVANCE PROCEDURES [7 CFR 3560.160]**

This section presents the process for resolving tenant grievances. Every step of the process will be explained with the responsibilities of each party involved. Topics covered in this section include when to file a complaint, the hearing process, requirements governing the hearing, and the hearing decision. It is important to note that a resolution that is in the best interest of everyone should have gone through the entire grievance process before a final decision was made.

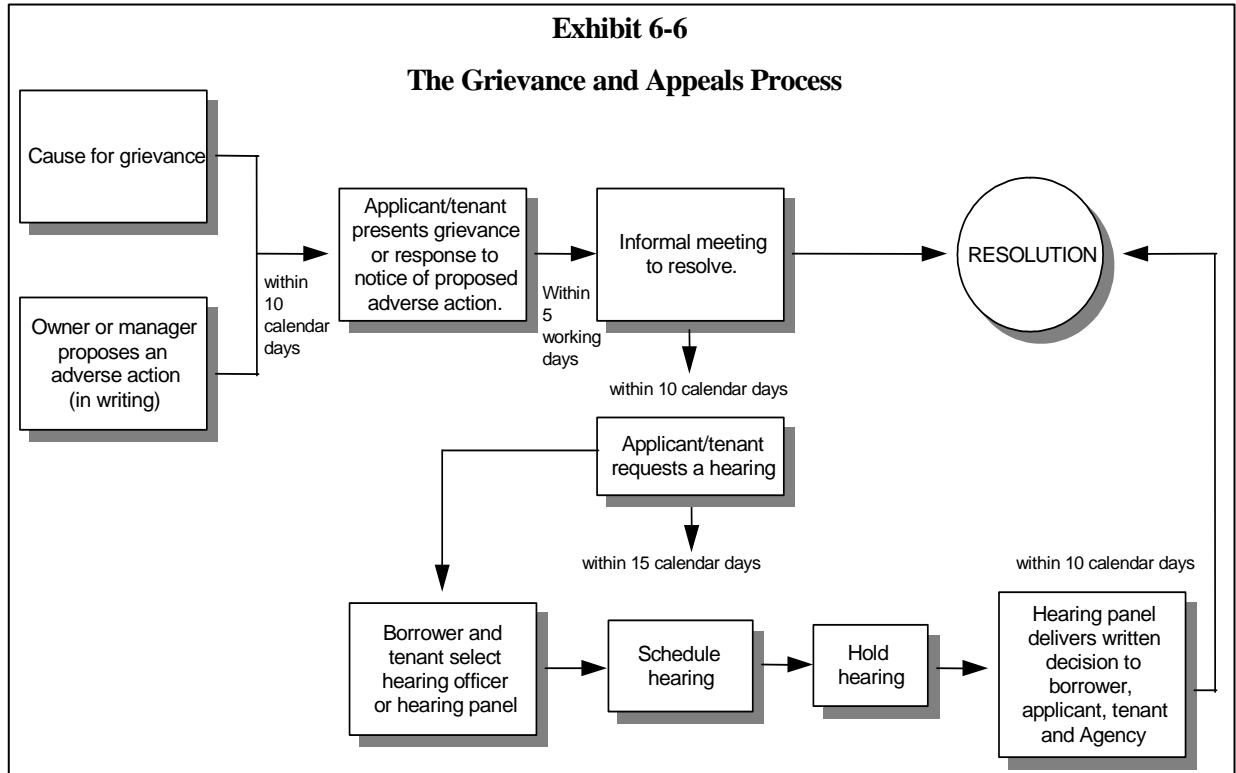
Tenants or prospective tenants may file a grievance in writing with the borrower in response to a borrower action, or failure to act, in accordance with the lease or Agency regulations that results in a denial, significant reduction, or termination of benefits or when a tenant or prospective tenant contests a borrower's notice of proposed adverse action as provided in Paragraphs 6.31 and 6.32.

### **6.31 NOTICE OF ADVERSE ACTION**

In the case of a proposed action that may have adverse consequences for tenants or prospective tenants such as denial of admission to occupancy and changes in the occupancy rules or lease, the borrower must notify the tenant or prospective tenant in writing. The notice must give specific reasons for the proposed action. The notice must also advise the tenant or prospective tenant of "the right to respond to the notice within 10 calendar days after date of the notice" and of "the right to a hearing in accordance with 7 CFR 3560.160 (f), which is available upon request." The notice must contain the information specified in 7 CFR 3560.160 (a)(2). For housing projects in areas with a concentration of non-English-speaking individuals, the notice must be in English and the non-English language.

### **6.32 OVERVIEW OF THE PROCESS**

The grievance process should always begin with an informal meeting between the grieved party and the borrower/management agent. It is the Agency's belief that the best way to resolve grievances is through an informal meeting between the two parties. Borrowers must offer to meet with tenants to discuss the grievance within 10 calendar days of receiving the grievance. If an informal meeting is held, the borrower must provide a summary of the meeting to the tenant within 10 calendar days of the meeting date. The Agency encourages borrowers and tenants or prospective tenants to make an effort to reach a mutually satisfactory resolution to the grievance at the meeting.



The parties will select a hearing panel or hearing officer to govern the hearing. Two weeks after the hearing, all parties are informed of the decision. Exhibit 6-6 provides an example of the grievance process.

### 6.33 WHEN IS A TENANT GRIEVANCE LEGITIMATE?

It is important for the management agent to determine if a tenant or prospective tenant's grievance is within the requirements established for the program. For example, "I want to file a complaint because the manager does not speak to me," is not a legitimate complaint. On the other hand, a complaint that the building manager fails to maintain the property according to the Agency guidelines is a legitimate complaint. Exhibit 6-7 lists the circumstances in which a tenant may or may not be able to file a complaint.



<b>Exhibit 6-7</b> <b>Tenant Complaints—Allowable Circumstances</b>	
<i>A complaint may <b>NOT</b> be filed if:</i>	<i>A complaint <b>MAY</b> be filed if:</i>
<ul style="list-style-type: none"> <li>• There is a proposed rent change that is authorized by the Agency.</li> <li>• A tenant or prospective tenant believes that they have been discriminated against. If a person believes that discrimination has occurred, they should file a complaint with the USDA’s Office of Civil Rights or the Secretary of HUD.</li> <li>• A project has formed a tenant’s association and all parties involved have agreed to use this association as a method of settling grievances.</li> <li>• There are changes in the rules that are required by the Agency and proper notice has been given.</li> <li>• The tenant is in violation of the lease and those violations result in termination of tenancy.</li> <li>• Disputes between tenants that do not involve the borrower/management agent.</li> <li>• Displacement or other effects as a result of prepayment.</li> </ul>	<ul style="list-style-type: none"> <li>• There is a modification of the lease, change in the rules, or changes in the rent that are not authorized by the Agency.</li> <li>• The borrower/management agent fails to maintain the property in a manner that is decent, safe, and sanitary.</li> <li>• The borrower violates a lease provision or occupancy rule.</li> <li>• Denial of admission to the project by a prospective tenant.</li> </ul>

### 6.34 BORROWER/MANAGEMENT AGENT RESPONSIBILITIES

The borrower/management agent is responsible for providing all tenants and prospective tenants with decent, safe, and sanitary housing. The following is a list of all of the responsibilities of the borrower/agent:

- Post all regulations, summary of regulations, or tenant information, including the equal housing opportunity poster, “and justice for all” poster, tenant grievance and appeals procedures, the AFHMP, occupancy rules, and office and emergency hours and phone numbers in a conspicuous place.
- Provide all tenants with a summary of their rights at the time the lease is signed and at each lease renewal. For tenants that are currently living in the project, a summary must be submitted once the summary is created.

- If the project has a large population of non-English-speaking tenants, the borrower/agent must provide the summary and any other documents that pertain to the tenant's rights, in the non-English language.

## **6.35 THE HEARING PROCESS**

### **A. Request for a Hearing**

- Each hearing process must begin with the request for a hearing. The tenant or prospective tenant must present their request within 10 days after the receipt of the summary of the informal meeting. The request must contain the following information:
  - ◇ The reason for the grievance or contest of the borrower/management agent's proposed action;
  - ◇ The action relief sought; and
  - ◇ Additional information.
- If the tenant or prospective tenant's request for a hearing is not received within the given time, the borrower or management agent's decision will become final.

### **B. Scheduling the Hearing**

The hearing must be scheduled 15 days after the receipt of the tenant's request for a hearing. If a hearing officer or hearing panel must be selected, the hearing will be scheduled within 15 days after the selection or appointment of a hearing officer or hearing panel. It is the responsibility of the two parties to agree upon a place and time that is mutually convenient to hold the hearing. If the two parties cannot agree on a place and time, it will become the responsibility of the hearing officer or hearing panel to make the decision.

### **C. Selection of the Hearing Officer or Hearing Panel**

The two parties must select a hearing officer. If the hearing officer cannot be agreed upon, the two parties will choose members to serve on the hearing panel. The hearing panel should consist of three members. The tenant and the borrower/management agent will each elect one person to the panel. It is then the responsibility of the two chosen members to elect a third member to the panel. If within 30 days from the time the request for the hearing was submitted a hearing panel has not been formed, the borrower/management agent must inform the Agency. Within 10 days of reviewing the facts, the Agency must appoint a hearing officer. Once a hearing officer or panel is selected the Agency must inform them in writing of their responsibilities for conducting the hearing.

Some helpful information that should be remembered by all parties involved in the process when selecting a hearing officer or hearing panel includes:

- Hearing panel members should be impartial, disinterested persons;
- The hearing officer cannot be a person previously considered by the tenant or borrower/management agent; and
- The hearing officer cannot be an Agency staff member.
- The hearing officer may not receive any payment unless that payment is made by the Agency.

**Potential Hearing Panel Members**

1. Legal aid counsel;
2. Someone with knowledge of the program; or
3. A Minister.

To minimize time and the level of effort, a management agent may elect to have a standing hearing panel for each project that they manage. If a standing panel is chosen, the above-listed process will have to be forfeited in lieu of the following process.

- A hearing panel consists of three members: one tenant panelist, one borrower/management agent panelist, and a chair.
- Tenants will get to nominate and vote for their panel members. A meeting must be held to allow the tenants the opportunity to choose two members to serve on the standing panel; one member will serve as the alternate. All residents should be notified of the time, date, and place where the election is going to take place. The borrower is responsible for ensuring that the notice is placed in a conspicuous place, within 2 weeks of the time the person is expected to start serving as a panel member. The meeting must also be held in a place that is convenient and accessible to the tenants.
- The borrower/management agent is responsible for selecting one or two members to serve on the standing panel. If two members are chosen, one will serve as the alternate.
- The third and “mutual” member of the panel will serve as the chair for the panel. The other two interested parties will elect the chairperson. Each party will only have the opportunity to give one vote, even if two people were elected to serve on the panel.
- Each member will serve on the panel for one year, with the opportunity for reelection. All members of the standing panel must be willing to render their services without compensation.

## D. Examination of Records

At a reasonable time before the hearing, the borrower/agent must allow the tenant the opportunity to examine all files that are going to be used during the hearing. Documents can be examined and copied if:

- The tenant is willing to cover any expenses that may be incurred;
- The document, record, or policy is one that will be used during the hearing process; and
- The document, record, or policy is not subject to any laws or confidentiality agreements that prohibit reproductions.

### Documents That May Not Be Copied

1. Credit reports;
2. Project budgets; and
3. Supervisory findings.

## E. Escrow Deposits

Tenants may establish escrow accounts if a grievance involves a rent increase not authorized by the Agency or if the borrower/agent is not maintaining the property in a decent and sanitary manner. The escrow account will allow the tenant the opportunity to make timely rent payments without having the borrower/agent receive the payment until the grievance has been settled. To maintain an escrow account, tenants must adhere to the following rules:

- All deposits must continue until the grievance is resolved;
- The institution that the escrow account is established in must be a Federally insured institution;
- All deposits must be made on time—failure to do so will terminate the entire process and all sums will be due immediately; and
- Tenants must make all receipts of deposit available for examination by the borrower/agent.

## 6.36 REQUIREMENTS GOVERNING THE HEARING

The hearing is an informal proceeding at which evidence is presented to a hearing officer or hearing panel. The hearing must be designed to ensure that the rights of all parties involved are protected. The hearing must protect:

- The right of both parties to be represented by counsel or another person(s) chosen as their representative;
- The right of the tenant or prospective tenant to a private hearing unless a public one is requested;

- The right of the tenant or prospective tenant to present oral and written evidence and arguments in support of their grievance or appeal, and to refute the evidence and crossexamine all witnesses on whose testimony or information the borrower or management agent relies; and
- The right of the borrower or management agent to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to confront and crossexamine all witnesses on whose testimony or information the tenant or prospective tenant relies.

During the hearing, each party must present evidence to support their position. All participants at the hearing must conduct themselves in an orderly manner. Participants that cannot conduct themselves in an orderly manner will be excluded from the proceedings or will cause the hearing panel or hearing officer to make a decision that is not in favor of the disorderly party.

#### **Remember**

The Agency approval is only to make sure that the decision is in compliance with other Agency programs.

If the tenant or prospective tenant or management agent fails to appear at a scheduled hearing, the hearing officer or hearing panel may choose to postpone the hearing for no more than 5 days or may determine that the party has waived their right to a hearing under this subpart. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. All parties involved in the hearing must be informed of the hearing panel's decision.

### **6.37 THE HEARING DECISION**

It is the responsibility of the hearing officer or hearing panel to prepare and submit a written decision to both parties within 10 calendar days of the hearing. The hearing officer or hearing panel must inform the Agency of the decision and the reasons for making that decision. The decision should be based on the facts that were presented during the hearing. The decision is not final until it has been approved by the Agency for compliance. This contingent form of approval should be noted in the decision letter. Upon receipt of the letter, the borrower and the tenant must comply with the directives specified in the decision.

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## SECTION 9: SPECIAL REQUIREMENTS FOR LABOR HOUSING

### *[7 CFR 3560.575 and 7 CFR 3560.624]*

While the Agency-sponsored Labor Housing programs have similar requirements in many respects to the Rural Rental Housing programs, because the target populations that these programs serve vary, there are some differences in program rules.

This section is designed to highlight these differences with regard to the occupancy rules. Unless otherwise noted below, the requirements throughout this chapter also apply to Labor Housing projects.

#### 6.38 OFF-FARM LABOR HOUSING

##### A. Eligible Tenants

Labor Housing tenants must meet all of the following criteria in order to be defined as an eligible tenant for the purposes of residing in labor housing:

- **Occupational.** An eligible household must include a tenant or co-tenant who is a domestic farm laborer, a retired or disabled domestic farm laborer, or must be a surviving household of a deceased domestic farm laborer.
- **Income.** The household must meet the definition of income eligibility as defined in Section 1 of this chapter. The current income limits for off-farm labor housing may be found in **Attachment 6-E**.
- **Occupancy.** The household must remain in compliance with the borrower's occupancy policy as established in Section 3 of this chapter.

If a household, upon recertification, is not in compliance with any of the above criteria, then it will be defined as an ineligible tenant and will be covered by Section 6.

##### B. Occupancy Priorities

###### *1. Properties without Rental Assistance*

When a borrower of a labor housing project without rental assistance is selecting the appropriate applicant for a vacant unit from the waiting list, the selection will be regulated by the following priorities:

- **First priority** must be given to eligible active farm laborer households, with first priority going to very low-income households, next to low-income households, and last to moderate-income households.
- **Second priority** must be given to retired or disabled domestic farm laborer households who were active in the local farm labor market area at the time of retirement or becoming disabled, with first priority going to very low-income households, next to low-income households, and last to moderate-income households.

- **Third priority** must be given to other retired or disabled domestic farm laborer households who were not active in the local farm labor market at the time of retiring or becoming disabled. Occupancy priority will be given first to very low-income households, next to low-income households, and last to moderate-income households.

Within each of the above priorities, occupancy priority within each ranking category is according to the household's income: very low, low, and then moderate.

#### **Example**

Project D has a vacant two-bedroom unit. On the waiting list, there are seven applicants eligible for a two-bedroom unit.

1. One applicant is a very low-income disabled farm laborer household from the local farm market area;
2. One applicant is low-income and 100 percent of the household's earnings are from farm labor;
3. One applicant is a low-income retired farm laborer household from another state;
4. One applicant is a low-income retired farm laborer household from the local farm market area;
5. One applicant is very low-income and 80 percent of the household's income comes from farm labor;
6. One applicant is a very low-income disabled farm laborer household from another county; and
7. One applicant is very low-income and 50 percent of the household's earnings are from farm labor.

The borrower must offer the vacant unit to these applicants in the following order.

1. First to the very low-income applicant for whom 80 percent of the household's earnings are from farm labor;
2. Second to the low-income applicant for whom 100 percent of the household's earnings are from farm labor;
3. Third to the very low-income applicant for whom 50 percent of the household's earnings are from farm labor;
4. Fourth to the very low-income disabled farm laborer household from the local farm market area;
5. Fifth to the low-income retired farm laborer household from the local farm market area;
6. Sixth to the very low-income disabled farm laborer household from another county; and
7. Seventh to the low-income retired farm laborer household from another state.



## **2. *Properties with Rental Assistance***

For labor housing units with rental assistance, the priorities listed above still apply. However, occupancy is first granted to all eligible very low-income farmworker households by ranked priority, then to low-income farmworker households by ranked priority. Moderate-income farmworkers may be served without rental assistance, when there are no very low- or low-income eligible farmworkers on the waiting lists, again by ranked priority.

### **Example**

Project E is a property that has rental assistance. It has a vacant two-bedroom unit. On the waiting list, there are six applicants eligible for a two-bedroom unit:

1. One applicant is a very low-income disabled farm laborer household from the local farm market area;
2. One applicant is low-income and 100 percent of the household's earnings are from farm labor;
3. One applicant is a low-income retired farm laborer household from another state;
4. One applicant is a very low-income retired farm laborer household from another county;
5. One applicant is a moderate-income farmworker household working in the local market area and 100 percent of the household's earnings are from farm labor; and
6. One applicant is very low-income and 50 percent of the household's earnings are from farm labor.

The borrower must offer the vacant unit to applicants in the following order:

1. First to the very low-income applicant for whom 50 percent of the household's earnings are from farm labor;
2. Second to the very low-income disabled farm laborer household from the local farm market area;
3. Third to the very low-income retired farm laborer household from another county;
4. Fourth to the low-income applicant for whom 100 percent of the household's earnings are from farm labor;
5. Fifth to the low-income retired farm laborer household from another state; and
6. Sixth to the moderate-income applicant for whom 100 percent of the household's earnings come from farm labor.

## **C. *Projects with Diminished Need***

When there is a diminished need for housing by persons or families who are eligible to reside in labor housing, units may be made available to persons or families eligible for occupancy under Section 1 of this chapter. Tenants admitted under this exception may

occupy the labor housing until such time the units are again needed by persons or families eligible under Paragraph 6.38 A of this section. As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence.

## **6.39 ON-FARM LABOR HOUSING**

### **A. Eligible Tenants**

The income restrictions and occupancy priorities listed throughout this chapter do not affect the occupancy of on-farm labor housing. This housing is owned by farm borrowers and is for the purpose of providing decent, safe, and sanitary housing to the specific farmer's employees. Occupancy of on-farm labor housing owned by farm borrowers is restricted to employees of the farmer or is governed by an employment contract with the farmer.

### **B. Ineligible Tenants**

For on-farm labor housing, ineligible occupants will include:

- The immediate relatives of the borrower(s); and
- Anyone who is not employed in domestic farm labor.

Ineligible tenants may occupy housing owned by farm borrowers with the permission of the Agency.

## ATTACHMENT 6-A

### ANNUAL INCOME SOURCES

#### INCOME INCLUSIONS

- (1) The full amount, before any payroll deductions, of wages and salaries, overtime pay, commissions, fees, tips and bonuses, and other compensation for personal services;
- (2) The net income from operation of a business or profession. Expenditures for business expansion or amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation of assets used in a business or profession may be deducted, based on straight line depreciation, as provided in Internal Revenue Service regulations. Any withdrawal of cash or assets from the operation of a business or profession will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested in the operation by the family;
- (3) Interest, dividends, and other net income of any kind from real or personal property. Expenditures for amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation is permitted only as authorized in paragraph (2) above. Any withdrawal of cash or assets from an investment will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested by the family. Where the family has net family assets in excess of \$5,000, annual income shall include the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by HUD;
- (4) The full amount of periodic amounts received from social security, annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts, including a lump-sum amount or prospective monthly amounts for the delayed start of a periodic amount, except as provided in paragraph (13) under Income Exclusions (e.g., Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, payments to the widow of a serviceman killed in action);
- (5) Payments in lieu of earnings, such as unemployment, disability compensation, worker's compensation, and severance pay, except as provided in paragraph (3) under Income Exclusions;
- (6) Welfare Assistance.
  - (a) Welfare assistance received by the family.
  - (b) If the welfare assistance payment includes an amount specifically designated for shelter and utilities that is subject to adjustment by the welfare assistance agency in accordance with the actual cost of shelter and utilities, the amount of welfare assistance income to be included as income shall consist of:
  - (c) The amount of the allowance or grant exclusive of the amount specifically designated for shelter or utilities; plus
  - (d) The maximum amount that the welfare assistance agency could in fact allow the family for shelter and utilities. If the family's welfare assistance is ratably reduced from the standard of need by applying a percentage, the amount calculated under this paragraph shall be the amount resulting from one application of the percentage;

- (7) Periodic and determinable allowances, such as alimony and child support payments, and regular contributions or gifts received from organizations or from persons not residing in the dwelling; and
- (8) All regular pay, special pay, and allowances of a member of the Armed Forces, except as provided in paragraph (7) under Income Exclusions.

## INCOME EXCLUSIONS

- (1) Income from employment of children (including foster children) under the age of 18 years;
- (2) Payments received for the care of foster children or foster adults (usually persons with disabilities, unrelated to the tenant family, who are unable to live alone);
- (3) Lump-sum additions to family assets, such as inheritances, insurance payments (including payments under health and accident insurance and worker's compensation), capital gains, and settlement for personal or property losses, except as provided in paragraph (5) under Income Inclusions;
- (4) Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member;
- (5) Income of a live-in aide, as defined in 24 CFR 5.403;
- (6) The full amount of student financial assistance paid directly to the student or to the educational institution;
- (7) The special pay to a family member serving in the Armed Forces who is exposed to hostile fire (e.g., in the past, special pay included Operation Desert Storm);
- (8)
  - (a) Amounts received under training programs funded by HUD (e.g., training received under Section 3);
  - (b) Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS);
  - (c) Amounts received by a participant in other publicly assisted programs that are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program;
  - (d) Amounts received under a resident service stipend. A resident service stipend is a modest amount (not to exceed \$200 per month) received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the project. Such services may include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident-initiative coordination. No resident may receive more than one such stipend during the same period of time; or
  - (e) Incremental earnings and benefits resulting to any family member from participation in qualifying state or local employment training programs (including training programs not affiliated with a local government) and training of a family member as a resident management staff person. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family member participates in the employment training program.
- (9) Temporary, nonrecurring, or sporadic income (including gifts);
- (10) Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era. (Examples include payments by the German and Japanese governments for atrocities committed during the Nazi era);

- (11) Earnings in excess of \$480 for each full-time student 18 years or older (excluding the head of household and spouse);
- (12) Adoption assistance payments in excess of \$480 per adopted child;
- (13) Deferred periodic amounts from supplemental security income and social security benefits that are received in a lump-sum amount or in prospective monthly amounts;
- (14) Amounts received by the family in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit;
- (15) Amounts paid by a state agency to a family with a member who has a developmental disability and is living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home; or
- (16) Amounts specifically excluded by any other Federal statute from consideration as income for purposes of determining eligibility or benefits under a category of assistance programs that includes assistance under any program to which the exclusions set forth in 24 CFR 5.609(c) apply. A notice will be published in the *Federal Register* and distributed to housing owners identifying the benefits that qualify for this exclusion. Updates will be published and distributed when necessary. The following is a list of income sources that qualify for that exclusion:
  - (a) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977 (7 U.S.C. 2017 [b]);
  - (b) Payments to Volunteers under the Domestic Volunteer Services Act of 1973 (42 U.S.C. 5044(g), 5058) (employment through AmeriCorps, Volunteers in Service to America [VISTA], Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, senior companions);
  - (c) Payments received under the Alaska Native Claims Settlement Act (43 U.S.C. 1626[c]);
  - (d) Income derived from certain submarginal land of the United States that is held in trust for certain Indian tribes (25 U.S.C. 459e);
  - (e) Payments or allowances made under the Department of Health and Human Services' Low-Income Home Energy Assistance Program (42 U.S.C. 8624[f]);
  - (f) Payments received under programs funded in whole or in part under the Job Training Partnership Act (29 U.S.C. 1552[b]); (effective July 1, 2000, references to Job Training Partnership Act shall be deemed to refer to the corresponding provision of the Workforce Investment Act of 1998 [29 U.S.C. 2931], e.g., employment and training programs for Native Americans and migrant and seasonal farmworkers, Job Corps, veterans employment programs, state job training programs, career intern programs, Americorps);
  - (g) Income derived from the disposition of funds to the Grand River Band of Ottawa Indians (Pub. L- 94-540, 90 Stat. 2503-04);
  - (h) The first \$2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the U. S. Claims Court and the interests of individual Indians in trust or restricted lands, including the first \$2,000 per year of income received by individual Indians from funds derived from interests held in such trust or restricted lands (25 U.S.C. 1407-1408);
  - (i) Amounts of scholarships funded under title IV of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs (20 U.S.C. 1087uu);
  - (j) Payments received from programs funded under Title V of the Older Americans Act of 1985 (42 U.S.C. 3056[f]), e.g., Green Thumb, Senior Aides, Older American Community Service Employment Program;

- (k) Payments received on or after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in *Re Agent*-product liability litigation, M.D.L. No. 381 (E.D.N.Y.);
- (l) Payments received under the Maine Indian Claims Settlement Act of 1980 (25 U.S.C. 1721);
- (m) The value of any child care provided or arranged (or any amount received as payment for such care or reimbursement for costs incurred for such care) under the Child Care and Development Block Grant Act of 1990 (42 U.S.C. 9858q);
- (n) Earned income tax credit (EITC) refund payments received on or after January 1, 1991, including advanced earned income credit payments (26 U.S.C. 32[j]);
- (o) Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub. L. 95-433);
- (p) Allowances, earnings, and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 U.S.C. 12637[d]);
- (q) Any allowance paid under the provisions of 38 U.S.C. 1805 to a child suffering from spina bifida who is the child of a Vietnam veteran (38 U.S.C. 1805);
- (r) Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of a crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602); and
- (s) Allowances, earnings, and payments to individuals participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931).

## **ATTACHMENT 6-B**

### **LEASE REQUIREMENTS**

#### **A. Lease Structure**

- All leases must be in writing.
- Initial leases must cover a one-year period.
- If the tenant is not subject to occupancy termination according to 7 CFR 3560.158 and 7 CFR 3560.159, a renewal lease or lease extension addendum must cover a one-year period.
- In areas with a concentration of non-English speaking tenants, leases must be available to tenants in both English and the appropriate additional language.
- Leases must give address(es) to which to direct complaints.
- Leases must include statement terms and conditions for modifying the lease.

#### **B. Required Lease Clauses**

Leases for all multi-family housing must include a number of specific clauses as listed below:

- The requirement to move or pay an increased rent if household income increases above moderate income. (This clause does not apply to leases for persons who are elderly, disabled, or handicapped and living in a full-profit plan development.)
- The requirement that tenants move out of the project within 30 days of being notified by the borrower that they are no longer eligible for occupancy unless the conditions cited in 7 CFR 3560.158(c) exist.
- The requirement that tenants notify borrowers regarding changes in income, citizenship, or number of persons living in the unit.
- The requirement for tenants to notify borrowers in a situation of extended tenant absences.
- The requirements for making restitution when a household receives benefits to which it is not entitled and a statement advising tenants that the submission of false information could result in the initiation of legal action by the Agency.
- The requirement that tenants agree to income certification.
- The requirement that the household's tenancy is subject to compliance with the terms of all applicable assistance programs covering the unit and/or project.
- The requirement that during acceleration and foreclosure proceedings:
  - ◊ The tenant contribution must remain as if interest credit and/or rental subsidy were still in place and available had acceleration not occurred; and

- ◇ The terms of the lease will remain in effect until the date acceleration and/or foreclosure is resolved.

Leases for tenants who have a *Handbook Letter 201 (3560)*, *Letter of Priority Entitlement (LOPE)* and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available.

Leases must contain an escalation clause permitting changes in basic/note rate rents before the lease expires. Changes must be approved by the Agency.

Leases must specify no escalation in tenant contribution due to loan prepayment or when rental assistance or interest credit is terminated due to the fault of management or the owner, or due to liquidation and acceleration of the note.

Leases must include statement that tenant's payment will not change if Federal subsidies paid to borrower on behalf of tenants are suspended or canceled, for the term of the lease.

Leases must include statement that the project is financed by the Agency and that the Agency has the right to further verify information provided by the applicant.

Leases must say that project is subject to:

- Title VI of the Civil Rights Act of 1964
- Title VIII of the Fair Housing Act
- Section 504 of the Rehabilitation Act of 1973
- The Age Discrimination Act of 1975
- The Americans with Disabilities Act

Leases must specify requirements (and exceptions) to move to the next available appropriately sized unit, if the unit becomes overcrowded, underused, or should the tenant no longer meet eligibility requirements.

Leases must include a provision that establishes when a guest will be considered a member of the household and be required to be added to the tenant certification.

Leases must include a provision that tenancy remains in place as long as the tenant's possessions remain in the apartment, even after tenant has left. This is the case until possessions are removed voluntarily or by legal means, subject to state and local law.

Leases for rental assistance units must include specific clauses. These clauses must be signed by the lessor and lessee, and specify:

- The tenant's gross monthly contribution, and under what circumstances it may change; and that
- The tenant contribution will not increase if rental assistance is terminated due to actions by borrowers.

For tenants living in Plan II interest credit units, leases must include a provision on gross monthly contribution.

All leases, including renewals, must include the following language:



“It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, state, or Federal law) while in or on any part of this apartment complex or cooperative is an illegal act. It is further understood that such action is a material lease violation. Such violations (hereinafter called ‘drug violation[s]’) may be evidenced upon the admission to or conviction of a drug violation. It is further understood that domestic violence will not be tolerated on Rural Housing properties, and that such action is a material lease violation. All perpetrators will be evicted, while the victim and other household occupants may remain in the unit in accordance with eligibility requirements.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation or domestic violence to vacate the leased unit permanently, within time frames set by the landlord, and not thereafter enter upon the landlord’s premises or the lessee’s unit without the landlord’s prior consent as a condition for continued occupancy by members of the tenant household. The landlord may deny consent for entry unless the person agrees not to commit a drug violation or domestic violence in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation or domestic violence, or has completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation or domestic violence, agrees to not commit a drug violation or domestic violence in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation or domestic violence, completed a counseling or recovery program within time frames specified by the landlord as a condition for continued occupancy in the unit. Should a further drug violation or domestic violence be committed by any nonadult person occupying the unit, the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land, the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law.”

For handicapped-accessible units occupied by those not needing its special features, a lease must discuss situations where management has made a temporary unit assignment, and specify who bears the cost of moving the tenant to another unit. Additionally, the lease clause must require the management to provide the tenant written notification when they must move within 30 days of notification from management that an eligible applicant with disabilities requires the unit.

The household in the unit with accessibility features will be required to move within 30 days of the housing project's receipt of a tenant application requiring accessibility features if another suitably sized unit without accessibility features is available in the project. If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until the first available unit in the project becomes available and then must move within 30 days.

Prepayment is subject to restrictive-use covenants. If prepayment occurs, leases and renewals must be amended to include a clause specifying tenant protections.

### **C. Required Information**

All leases must contain the following information and provisions:

- The name of the tenant, any co-tenants, and all members of the household residing in the unit.
- The identification of the unit.
- The amount and due date of monthly tenant contributions and late payment penalties.
- The utilities, services, and equipment to be provided for tenants.
- The tenant's utility payment responsibility.
- The certification process for determining tenant occupancy eligibility and contribution.
- The limitations of the tenant's right to use or occupancy of the dwelling.
- The tenant's responsibilities regarding maintenance and obligations if tenant fails to fulfill these responsibilities.
- The agreement of management to accept tenant payment regardless of other charges that the tenant owes, and management's agreement to seek legal remedy for collecting other charges accrued by the tenant.
- The maintenance responsibilities of management in buildings and common areas, according to state and local codes, Agency rules, and fair housing requirements.
- The responsibility of management at move-in and move-out to provide tenants with a written statement of the unit's condition, and provisions for tenant participation in inspection.
- The provision for periodic inspections by the borrower or management, and other circumstances under which management may enter the premises while a tenant is renting.
- The tenant's responsibility to notify management of an extended absence, as defined in the lease.
- The agreement that tenants may not sublet the property without management or Agency consent.

- The provision regarding transfer of the lease if the project is sold to an Agency-approved buyer.
- The procedures that must be followed by management and the tenant in giving notice required under terms of the lease.
- The good-cause circumstances under which management may terminate the lease and length of notice required.
- The disposition of the lease if the housing becomes uninhabitable due to fire or other disaster, including the borrower's rights to repair the building or terminate the lease.
- The procedures for resolution of tenant grievances consistent with the requirements of 7 CFR 3560.160.
- The terms under which a tenant may, for good cause, terminate a lease with 30 days' notice prior to lease expiration.
- The signature clause indicating that the lease has been executed by the borrower and the tenant.

**D. Projects and Units Receiving HUD Assistance**

In multi-family projects receiving project-based assistance under Section 8 of the Housing Act of 1937, borrowers may use the HUD model lease. The provisions of the HUD model lease will prevail, unless they conflict with Agency lease requirements in accordance with this section. If there is conflict between HUD requirements and Agency requirements, the provision that will be enforced will be the one that is most favorable to the tenant.

A clause must be inserted into the lease requiring that tenants ineligible at recertification must leave the property unless allowed to stay under their HUD lease.

For HUD Section 8 certificate and voucher holders, borrowers may use:

- A standard HUD-approved lease;
- A HUD-approved lease that includes a number of modifications; or
- An Agency-approved lease if acceptable to HUD or the local housing authority.

**E. State and Local Requirements**

Borrowers must use a lease that is consistent with state and local requirements.

- If any lease provision is in violation of state or local law, the lease may be modified to the extent needed to comply with the law, but any changes must be consistent, to the greatest extent possible, with the required provisions established in 7 CFR 3560.156(c).
- Leases must include procedure for handling tenant's abandoned property, as provided by state law.

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## **ATTACHMENT 6-C**

### **PROHIBITED LEASE CLAUSES**

Borrowers are prohibited from including any of the following clauses in the lease:

- Clauses prohibiting families with children under 18.
- Clauses prohibiting occupancy by a handicapped person willing and able to modify the unit at their own expense.
- Clauses requiring prior consent by tenant to any lawsuit that borrowers may bring against the tenant in connection with the lease.
- Clauses authorizing borrowers to hold any of a tenant's property until the tenant fulfills an obligation.
- Clauses in which tenants agree not to hold borrowers liable for anything they may do or fail to do.
- Clauses in which tenants agree that borrowers may bring suit against the tenant without notice.
- Clauses in which tenants agree that borrowers may evict the tenant or sell their possessions whenever they determine that a breach or default has occurred.
- Clauses authorizing the borrower's attorney to appear in court on behalf of the tenant, and to waive their right to a trial by jury.
- Clauses authorizing the borrower's attorney to waive the tenant's right to appeal or to file suit.
- Clauses requiring the tenant to agree to pay legal fees and court costs whenever the borrower takes action against the tenant, even though court may find in favor of the tenant.

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## **ATTACHMENT 6-D**

### **ACQUIRING AUTOMATION SUPPORT FOR MINC OR OTHER AUTOMATION NEEDS**

The Agency will approve the use of project funds to acquire automated support to participate in MINC. While operating costs will be reduced in the long term, there may be some short-term increases to accommodate the initial acquisition of automated support.

Guidelines for obtaining automated support for MINC are as follows:

- With prior Agency approval, borrowers may use project operating or reserve funds to purchase or lease hardware or software needed to participate in MINC.
- Once borrowers have acquired automation capabilities, they may allow their management agent to use them to participate in MINC. This cost may be prorated over several projects owned by different borrower entities with a common management agent.
- When the cost of acquiring management software or hardware is not cost effective for a project (or multiple projects with common management), the Agency may allow the cost of contracting with a service bureau to provide automation support as a project operating expense.
- To request Agency approval, borrowers must submit a brief proposal that documents the anticipated costs and benefits of adopting the automation strategy being proposed.

#### **1. Acquiring Additional Automation Capabilities**

It is important to note that the approval for the use of project funds discussed above extends only to the portion of the computer software and hardware needed to participate in MINC. If additional software or hardware capacity is desired by the borrower, the following applies:

MFH borrowers are encouraged to use automated systems to manage MFH projects and to prepare and process paperwork associated with project management. Where economically feasible, computer applications can improve management efficiency and reduce errors and omissions. However, the purchase of computer hardware and software out of project funds should be carefully analyzed.

If a borrower entity's purchase of computer hardware or software to be used solely at a project can be expected to show a reduction in project operating and maintenance expenses, the purchase cost may be approved by the Agency as a line item project expense. The expense may be approved at project inception out of the project's two percent initial operating account or subsequent to project start-up out of annual operating revenues. The cost may be prorated over several projects owned by the same borrower entity. Any computer hardware or software purchased with project funds must remain with the project if there is any subsequent change in management or ownership of the project.

The purchase or use of computer hardware or software by a management company, versus a borrower entity with or without an identity of interest with a borrower, may not be considered an allowable line item expense on an Agency approved project budget.

## **2. Choosing to Use a Service Bureau**

If acquiring automation is not a sound decision, borrowers may consider using a service bureau to provide automation services at a fee. The fee can be a project expense and should be reasonable. The Agency must approve a borrower's determination that it is in the best interest of the project to contract with a service bureau.

The cost of a service bureau is essentially an "add-on expense" to an operating budget, since the function is not currently performed by any project. Borrowers who find that their project budget will not support the cost of acquiring automation support or a service bureau fee should contact their servicing office to be excepted from mandatory participation in MINC.

The Agency will not allow an add-on fee for the cost of a service bureau if the borrower's analysis demonstrates that it is less expensive to acquire an automation capacity, unless extenuating circumstances exist.

The Agency will not approve the use of an add-on service bureau fee as a project expenses for a contract with a firm that has an Identify-of-Interest (IOI) with the project borrower or management agent, without detailed documentation indicating that the IOI service bureau is clearly more cost effective than a non-IOI service bureau. While this policy does not restrict the formation of IOI firms to process tenant certifications, service bureau companies or the payment for their services from a management fee, it is intended to address concerns expressed by the Office of the Inspector General (OIG) that IOI firms may unnecessarily inflate project operating expenses.



**ATTACHMENT 6-E**  
**FEDERAL REGIONAL INCOME LIMITS**  
**FOR HIRED FARMWORKERS**

Region I—(\$7,200) Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

Region II—(\$5,400) New Jersey and New York. (Includes Puerto Rico and the USVI.)

Region III—(\$6,000) Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia.

Region IV—(\$6,150) Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee.

Region V—(\$6,300) Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

Region VI—(\$6,900) Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

Region VII—(\$7,200) Iowa, Kansas, Missouri, and Nebraska.

Region VIII—(\$7,350) Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming.

Region IX—(\$8,850) Arizona, California, Hawaii, and Nevada.

Region X—(\$7,050) Alaska, Idaho, Oregon, and Washington.

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## CHAPTER 7: RENTS, SHELTER COST, AND UTILITY ALLOWANCES

### 7.1 INTRODUCTION

The purpose of the low interest rate loans that the Agency makes is to enable borrowers to set rents at rates that are affordable to low- and moderate-income tenants, the target occupants for Agency-financed multi-family housing. Rents provide the necessary income stream to maintain and operate the housing. Thus, the Agency has a twofold interest in maintaining the rent streams in multi-family housing to protect the value of the property at affordable rates.

This chapter presents the program rules regarding rents, occupancy charges, and utility allowances for multi-family housing projects and the Agency's procedures for determining borrower compliance, including those for Farm Labor Housing projects. After reading this chapter, the Loan Servicer will understand the various types of project rents and how they are set, how rents are to be paid by tenants and collected and reported on by the borrower, and the procedure for changing rents in a project. They will also learn how security deposits are set and when they may be collected.

The Agency defines "rent" as the amount established as a charge for occupancy in a rental unit of Agency-financed multi-family housing. Rents must be established at the same rate for all similar units in the housing project: basic or note rent plus the utility allowance (when used) or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

Unless otherwise noted, for purposes of this discussion the term "rents" refers to both rents and occupancy charge, and "tenants" refers to both tenant and members of a cooperative.

### SECTION 1: RENT REQUIREMENTS

#### 7.2 RENT REQUIREMENTS BY PROJECT TYPE [7 CFR 3560.202]

##### A. Major Rent Levels

Subject to Agency approval, borrowers set project rents and utility allowances based on debt service and reasonable operating and maintenance expenses. Projects will have one or more of the following four rents:

- **Note rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in *Form RD 3560-52, Promissory Note*.
- **Basic rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in *Form RD 3560-52* reduced by the interest credit agreement.

- **U.S. Department of Housing and Urban Development (HUD) contract rent** is the rental charge established for housing receiving project-based HUD Section 8 rental subsidies in accordance with 24 CFR Part 880 or Part 884, as applicable.
- **Low-income housing tax credit (LIHTC) rent** is the rental charge established in accordance with LIHTC requirements.

## B. Rent Levels by Project Type

These rent levels will apply depending upon the project type as follows:

- Plan I projects, direct and full-profit projects with loans made prior to 1968, and unrestricted Farm Labor Housing projects all have rents that are note rate only. Tenants all pay the same rent depending upon the size of their unit.
- Plan II projects have a minimum rent that is the basic rent and a ceiling rent that is the note rate rent. Tenants without rental subsidies (see Chapter 8, Rental Subsidies, for details) pay a rent within that range, based on their incomes. Tenants with rental assistance pay the basic rent, although the rental subsidy may pay all or a portion of the rent on behalf of the tenant.
- HUD Section 8 projects with interest credit have a minimum basic rent, a maximum note rate rent, and a HUD rent.
- HUD Section 8 projects without interest credit have a note rate rent and a HUD rent.

Exhibit 7-1 summarizes the rents that appear in each project type.

<b>Exhibit 7-1</b>	
<b>Rents by Project Type</b>	
<b>Project Type</b>	<b>Rents</b>
Plan I projects	Note rate
Plan II projects	Note rate, basic
Section 8/515 projects without interest credit	Note rate, HUD contract rent
Section 8/515 projects with interest credit	Note rate, basic rent, HUD contract rent
Early projects (pre-1968, direct loan and full profit projects)	Note rate
Labor housing—On Farm	No rent or basic rent
Labor housing—Off Farm	Note rate
Congregate housing/group homes	Note rate, basic
Cooperatives	Note rate, basic

### **C. Setting Rent Levels**

Rents are set by unit size and established by the borrower through a project budget at levels adequate to cover debt service, reasonable project operating expenses, and a return to owner if appropriate. Initial rents and any changes must be approved by the Field Office as part of the project budget approval process. Chapter 4 addresses procedures for determining whether project budgets are reasonable.

## **7.3 UTILITY ALLOWANCES [7 CFR 3560.202]**

When tenants pay some or all of their utility costs themselves, borrowers must establish a utility allowance to determine the amount tenants pay toward rent. The utility allowance is deducted from the total shelter cost calculated for the tenant, and the difference is paid by the tenant as rent. If the tenant is entitled to a utility reimbursement, management companies may issue a joint check payable to the tenant and utility company, if they choose to do so.

### **A. Setting Utility Allowances**

The utility allowance is based on expected costs for utilities. Once established, the borrower must update the utility allowance annually. This is done in conjunction with the annual budget process. The borrower must submit *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* to the Field Office and follow the procedures described in Section 4 of this chapter.

### **B. Approving Utility Allowances**

Field Office Staff must review the utility allowance documents submitted with the budget to make sure that the numbers being used are reasonable and comparable to other projects in the same market area. The Loan Servicer should check current rate schedules and known rate increases from such sources as suppliers of electric utility, natural gas utility, water and sewer service, fuel oil and bottle gas; public service commissions; real estate and property management firms; and state and local agencies, including public housing authorities. In addition, the Loan Servicer should check project budgets of any other Agency-funded projects in the area to see if utility allowances are similar. Chapter 4 provides further guidance on revising cost increase justifications.

### **C. Monitoring Utility Allowances**

To make sure that borrowers are correctly applying utility allowances, servicing staff must check tenant leases during site monitoring visits of projects where tenants pay their own utilities. These leases should reflect the current utility allowances as shown on the current approved budget for the project.

## **7.4 DETERMINING TENANT RENT PAYMENT [7 CFR 3560.203]**

Tenants pay rents in an amount that depends on the project type, whether utilities are included in the rent, the tenant's income, and the availability of rental subsidy.

*Form RD 3560-8, Tenant Certificate* is used to determine individual rents. Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in accordance with 7 CFR 3560.152.

### **A. Net Tenant Contribution**

*Form RD 3560-8* is used to calculate a tenant's rent based on their income. The net tenant contribution to rent must not exceed the highest of:

- Thirty percent of monthly adjusted income, with an adjustment for any utility allowances, or
- Ten percent of gross monthly income, with an adjustment for any utility allowances, or
- If the household is receiving payment for public assistance from a public agency, the portion of such payment which is specifically designated by that agency to meet the household's shelter costs, or
- The basic rent, unless Rural Housing Service (RHS) rental assistance is provided to the household.

For an example of how to calculate the net tenant contribution, refer to Exhibit 7-2.

**Exhibit 7-2****Examples—Net Tenant Contribution**

**Example 1:** The basic rent for a one-bedroom unit at Beautiful Acres Apartments is \$350 and the note rate rent is \$450. Tenants at Beautiful Acres pay their utilities directly, so there is a utility allowance of \$60. *Form RD 3560-8* for Joe Smith shows that he has an annual income of \$12,000. Since he is elderly, he receives a \$400 adjustment for elderly status, giving him an adjusted annual income of \$11,600. In completing *Form RD 3560-8*, the site manager calculates that 30 percent of Mr. Smith's adjusted monthly income is \$290 and 10 percent of his gross monthly income is \$100. Since he is receiving no payment for public assistance, the site manager enters \$290 on line 30 (which is the highest of 30 percent of adjusted income, or 10 percent of monthly gross income, or the public assistance payment) of *Form RD 3560-8* as the Gross Tenant Contribution. The utility allowance must then be deducted, leaving a unit rent payment by Mr. Smith of \$230.

Basic Rent	\$350
Note Rate Rent	\$450
Utility Allowance	\$60
Mr. Smith's Annual Income	\$12,000
Adjustment for Elderly Status	\$400
Adjusted Annual Income	\$11,600
30 Percent Adjusted Monthly Income	\$290
10 Percent Gross Annual Income	\$100
Payment for Public Assistance	\$0
Highest of Above	\$290
Deduction for Utility Allowance	\$60
Unit Rent Payment for Mr. Smith	\$230

**Example 2:** Joe Smith has decided to move to Cozy Home Apartments. The rents there include utilities. The basic rent for a one-bedroom unit for which he qualifies is \$360 and the note rate rent is \$460. His income information is the same, which means \$290 is again entered onto line 30, Gross Tenant Contribution, of *Form RD 3560-8*. Since there is no utility allowance, Mr. Smith will make a unit rent payment of \$290.

Basic Rent	\$360
Note Rate Rent	\$460
Utility Allowance	\$0
Mr. Smith's Annual Income	\$12,000
Adjustment for Elderly Status	\$400
Adjusted Annual Income	\$11,600
30 Percent Adjusted Monthly Income	\$290
10 Percent Gross Monthly Income	\$100
Payment for Public Assistance	\$0
Highest of Above	\$290
Deduction for Utility Allowance	\$0
Unit Rent payment for Mr. Smith	\$290

## **B. Unit Rents**

### ***1. Note Rate Rents***

In projects with note rate rents only, tenants will pay the note rate rent, regardless of income, unless they are income ineligible, in which case they will pay a surcharge (see Paragraph 7.3 D).

When a Plan II project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a Special Note Rent (SNR) to attract or retain tenants whose income level would require them to pay note rent. An SNR is less than the note rent but is higher than the basic rent. The requirements for requesting and receiving an SNR are established under 7 CFR 3560.454.

### ***2. Basic Rents***

In projects with basic and note rate rents, tenants will pay their net tenant contribution, but no less than the basic rent and no more than the note rate rent.

### ***3. Rental Assistance Rents***

Tenants who are eligible to receive available rental assistance in a project pay the net tenant contribution. Rental assistance makes up the difference between the net tenant contribution and approved shelter costs (basic rent). Chapter 8 provides further details on charging and collecting rents from tenants with rental assistance.

### ***4. HUD Section 8/USDA Section 515 Rents***

In projects with HUD Section 8 assistance contracts, HUD sets the rents and utility allowances and tenants pay the borrower rent the total tenant payment (TTP), which is the greater of: 30 percent of monthly adjusted income or 10 percent of gross income; welfare rent or; \$25. The HUD rent should never be less than the basic rent. If it is, the borrower must make up the difference, since it cannot be collected from the tenant.

### ***5. Tenant-Based Subsidies***

Tenants with tenant-based subsidies such as HUD certificates pay the rents established at the project. If the voucher is less than the project rent, the tenant is responsible for the difference. If a voucher is in excess of the note rate rent, the voucher will be accepted, and the difference between the note rate rent and the voucher value is deposited to the operating account.

## **C. Overage**

Overage is that portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal to the difference between the note rent for a

### **Example**

Jimmy Smits pays \$180 a month in rent, which is 30 percent of his adjusted monthly income. The basic rent is \$150. The \$30 difference between the basic rent and Mr. Smits's rent payment is called overage.



unit and the basic rent.

#### **D. Unit Rents for Ineligible Tenants**

There will be times when ineligible tenants occupy multi-family housing units. Such tenants must pay rent based on the type of project they occupy.

##### ***1. Surcharge for Ineligible Tenants in Plan I Projects***

Ineligible tenants occupying a Plan I project must pay the established note rate rent plus a rent surcharge of 25 percent of the established rent. A Plan I project is defined in 7 CFR 3560.11.

##### ***2. Income-Ineligible Tenants in Plan II Projects***

Income-ineligible tenants occupying Plan II projects must pay the note rate rent. A Plan II project is defined in 7 CFR 3560.11.

#### **E. Unit Rents for Site Managers, Caretakers, and Owner-Occupied Units**

The rent for a unit occupied by a site manager, caretaker, or owner-occupied unit will depend upon whether the unit is being used as a revenue-producing unit. When the unit is being used as a revenue-producing unit, rents for units occupied by a site manager or caretaker are calculated as for any other tenant, on the basis of income.

For a non-revenue-producing unit, project rental rates will be established as if the unit did not exist as living quarters and will be properly coded in Multi-Family Information System (MFIS). However, *Form RD 3560-8* will not be prepared in this instance.

With prior approval of the State Director, an owner may occupy a unit in the project when the owner will manage the project rather than hiring a management agent or site manager. If the unit is a revenue-producing unit, rental rates will apply to the borrower as they would to any other caretaker or manager.

#### **F. Unit Rents for Low Income Housing Tax Credit Units**

##### ***1. Setting and Collecting Rents***

Unit rents in projects with LIHTCs will be set in accordance with regular Agency program rules. Two examples of setting such rents are provided in Exhibit 7-3. The Field Office must be aware that the LIHTC program prohibits owners from charging tenants more than a certain amount of rent in LIHTC units. Borrowers who do this risk recapture of their tax credits and stiff penalties. While the law does not allow the borrower to collect basic rent from the tenant if it exceeds the LIHTC limitation, overage may be collected from the tenant in only those projects with 1991 and later tax credit allocations, if necessary, according to *Form RD 3560-8* and even if that rent exceeds the LIHTC limitations.

**Exhibit 7-3****Setting Unit Rents for Section 515 Projects with LIHTCs**

**Example 1:** Assume the units receive only interest credit and no rental assistance or HUD Section 8 assistance. One-bedroom apartment: basic rent = \$275, LIHTC rent = \$250. The expense level required to meet financial requirements of the project exceeds the rent allowed to be charged by the low-income housing LIHTC program by \$25.

**Example 2:** Assume a project where LIHTC rent is equal to or greater than the basic rent, and a previously eligible tenant's household income increases beyond the LIHTC rent. In this case, the tenant may or may not have previously received rental assistance or HUD Section 8. Example: One-bedroom apartment: basic rent = \$250, LIHTC rent = \$300. Only one co-tenant works. Household pays \$200 per month and rental assistance is \$50. Household is Agency and LIHTC eligible. Second co-tenant goes to work, causing the household rent to go up to \$350. The new rent level exceeds both basic and LIHTC rents. Overage of \$100 is due. LIHTC rent limitations require that the owner charge tenants no more than \$300, which causes a shortage of \$50 per month in overage due the Agency. Therefore, the owner is accountable for this shortage if the project was allocated LIHTCs prior to 1991. For projects allocated LIHTCs after 1990, the owner is allowed to collect the overage due from the tenants because gross rent that tenants pay in the LIHTC unit does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Agency under Section 515. The tenant cannot be required to move based on LIHTC ineligibility.

**2. Agency Review and Monitoring of LIHTC Rents**

The law does not excuse the borrower from paying the basic rents required to the Agency; these rents must be deposited into the operating account in full. Borrowers must be informed by Loan Servicers that the borrowers are responsible for funding any gap between basic rents and tax credit rents collected from tenants when basic rent exceeds LIHTC rents. This fact should be noted when the Loan Servicer reviews the project operating budget.

Borrowers must not use project funds to make up any difference between rents required under Agency program rules and the maximum allowed rents under the LIHTC program, and they must collect the required rents. During the annual review process, Loan Servicers should review the previous year's budget with a focus on any cash shortfalls. If the Loan Servicer determines that a shortfall exists due to differences between tax credit limitations and basic rents, they must ensure that a provision is made in the coming year's budget and future years on line 11, "Cash-non project" of *Form RD 3560-7* for the owner to contribute necessary funds to meet the required rents.

**G. Adjustments to Unit Rents**

Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in accordance with 7 CFR 3560.152. Borrowers are not required to recertify a household

prior to the annual recertification unless a change in household income of \$100 or more per month occurs. If a tenant requests it, the borrower must recertify the tenant for a change in household income of \$50 or more per month (see Chapter 6 for further details on interim recertifications).

A change in household status could take place in any one of the following circumstances:

- The tenant has had a change in income (increase or decrease);
- The tenant has had a change in the size of the household (increase or decrease in number of people residing in the unit); or
- The tenant has had a change in the type of household (the household may become handicapped or elderly, or a 17-year-old child may turn 18).

If *Form RD 3560-7* shows that a change in rents is in order as a result of the change in household status, the effective date of a tenant's changed rent is the first day of the month following third-party verification of the tenant's reported changes. However, the management agent must complete the verification process no later than 30 days following the tenant's notice of the change.

## **7.5 RENTS DURING EVICTION OR FAILURE TO RECERTIFY [7 CFR 3560.208]**

Tenants must continue to pay rents during termination through eviction and if they are not recertified for occupancy.

### **A. Rents for Tenants Being Evicted**

Tenants must continue to pay rents as per *Form RD 3560-8* while the eviction process is underway.

### **B. Rents for Tenants without a Current Certification**

A tenant who is not recertified is technically an ineligible tenant, and note rate rent must be collected and deposited to the general operating account for that tenant. Whether the tenant or the borrower/management agent pays the note rate depends upon who is to blame for the failure to recertify.

#### ***1. Tenant Failure to Recertify***

If a borrower can document that a tenant received a notice specifying a tenant recertification date, and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, will give the tenant and the Agency written notification that:

- Termination proceedings are being initiated, in accordance with 7 CFR 3560.159; and
- The tenant will be charged note rent until the tenant's lease is terminated.

## **2. Borrower Failure to Recertify**

If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants will continue to make net tenant contributions to rent based on their most recent *Form RD 3560-8*. The borrower must remit to the Agency full overage as if the tenant was paying the note rent until the tenant is recertified.

## **7.6 IMPROPERLY ADVANCED RENTS [7 CFR 3560.209]**

Improperly advanced interest credit or rental assistance, whether it was the fault of the borrower or the tenant, will be recaptured in accordance with the requirements established by 7 CFR part 3560, subpart O.

### **A. Borrower Error**

When rents have been improperly collected from a tenant due to borrower error, such as a miscalculated *Form RD 3560-8* the borrower must make up the difference to the Agency for any additional rents that should have been collected or reimburse the tenant for any excess rents collected.

### **B. Tenant Fraud**

When the borrower has collected an incorrect rent amount from the tenant due to tenant fraud, the borrower must make every attempt to recapture the rent due from the tenant. Once the borrower has delivered documentation to the Loan Servicer of failed attempts to collect, the Loan Servicer must comply with the requirements of 7 CFR part 3560, subpart O to pursue collection.

## **7.7 MONITORING TENANT CONTRIBUTION AND UNIT RENTS**

### **A. Borrower Monthly Submissions**

The Loan Servicer monitors unit rents and tenant contributions on a monthly basis via the project worksheet and *Form RD 3560-8*. This information is verified during site visits through random interviews with tenants.

### **B. Site Visits**

The Loan Servicer will verify information on *Forms RD 3560-29* and *RD 3560-8* during site visits through random tenant interviews. If the Loan Servicer is told by any tenant that they pay a different amount of rent than is shown on *Form RD 3560-9, Interest Credit and Rental Assistance Agreement*, for that tenant, the Loan Servicer must ask the borrower or management agent to explain the discrepancy.

## **SECTION 2: SECURITY DEPOSITS**

### **7.8 SECURITY DEPOSITS [7 CFR 3560.204]**

Borrowers should collect security deposits as assurance of rental payment or charges for damages when it is reasonable and customary for the area in which the project is located. Security deposits are largely governed by state and local laws; Loan Servicers must familiarize themselves with those laws. The state Office of General Counsel (OGC) can direct Field Officer Staff to the location of information on these laws in that particular state.

#### **A. Allowable Amounts**

The borrower must specify the amount of the security deposit that will be charged in a project by unit size in the management plan and in the dwelling lease. This amount may not be changed without prior consent of the Agency. The following requirements must be met:

- Borrowers may charge security deposits in an amount that is typical for the area, but the security deposit charged to a tenant may not exceed that tenant's contribution for one month's rent or the basic rent, whichever is greater;
- Households receiving a HUD rental subsidy must pay security deposits according to HUD requirements;
- Members in a cooperative must pay a membership fee equal to one month's occupancy charge; and
- Security deposits for tenants may not be increased in later years, even if the tenant has been residing in the project for a long time and the initial amount charged is not representative of current basic rents or security deposits.

#### **B. Payment Plans**

If such tenants cannot pay the full amount of the security deposit initially, they may be placed on a payment plan. Should installments not be met, the total charge may become due and payable in full.

#### **C. Authorized Uses**

Funds in the security or membership fund account must only be used for authorized purposes as specified by the borrower's management plan.

Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts. An itemized accounting for any charges against the security deposit must be presented to the tenant after the move-out inspection, unless the tenant has abandoned the project and their whereabouts are unknown and cannot be ascertained after reasonable inquiry. Resolution of any security deposit disputes must be handled in accordance with state and local laws.

Any amount which is kept by the borrower as a result of lease or occupancy agreement violation must be transferred to the general operating account and treated as income of the housing.

#### **D. Accounting and Interest**

Security deposits must be held in a separate bank account in a Federally insured institution in accordance with 7 CFR 3560.302 (see Chapter 3). These funds are held in trust for the tenant until used or returned to the tenant.

Any interest earned on security deposits will accrue in accordance with state law, but in no case will it accrue to the project management or the borrower. If a state requires the borrower to pay the interest earned on security deposits and the borrower collects more interest than is required by the state, the additional interest must be deposited into the general operating account for use by the project.

Any security deposits unclaimed by a tenant must accrue to the project and must be deposited by the borrower into the general operating account.

#### **E. Additional Deposits**

Borrowers may charge additional deposits for pets; however, these must not exceed basic rent for the animal owner's unit. Where a service animal is necessary for the normal function of a household member, an additional security deposit must not be charged.

Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

### **7.9 MONITORING SECURITY DEPOSITS**

Loan Servicing staff will monitor security deposits charged to and collected from tenants during onsite monitoring visits by:

- Reviewing project annual financial statements;
- Reviewing dwelling leases and comparing the amount charged with what has been specified in the current management plan;
- Reviewing bank statements to see what the deposits of security deposits total; and

- Asking tenants to confirm what they have paid as security deposits.

Any discrepancies must be explained by the borrower or management agent. Monitoring of security deposit accounts is further addressed in Chapter 3.

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## SECTION 3: RENT COLLECTION

### 7.10 RENT COLLECTION [7 CFR 3560.209]

Borrowers must collect rent on a monthly basis. Rents should be due on the first day of the month. The time and place of onsite collection and/or the address for payment by mail should be well publicized and consideration should be given to an after-hours depository, if needed. Borrowers must maintain an accounting system to collect and track receipts that can be audited.

#### A. Tracking Rents

Any collection system employed by the borrower must include the following:

- A serially numbered receipt book or similar device to track collections;
- A ledger that shows which tenants have paid their rents and which have not; and
- If collections are held onsite, they must be secure. A safe may be used to ensure security.

The borrower must explain how the above requirements are to be met in the management plan. The Loan Servicer will verify that these requirements are being met during onsite supervisory visits by asking to see the receipt book or similar tracking device, the ledger, and the onsite collection device, if any.

#### B. Fees for Late Payments

Borrowers may institute a schedule of late fees. The Loan Servicer can automatically approve a schedule provided in the management plan that provides for:

- A grace period of 10 days from the rental charge due date; and
- A late payment penalty that does not exceed the higher of \$10 after the grace period or an amount equal to 5 percent of the tenant's gross tenant contribution.

Any other type of schedule must be submitted by the borrower to the Agency for approval. All schedules must be in accordance with state and local laws and must be justifiable. To approve the schedule, the Loan Servicer needs to make sure that the fees are not excessive, are customary for the area, and allow for a reasonable grace period.

Tenants that receive housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

The borrower must describe any late fee schedule in the management plan. During the onsite supervisory visit, the Loan Servicer must ask tenants about the late fees schedule to make sure it is as the borrower has described it. The Loan Servicer must also check leases to confirm that the late fee schedule is stated and matches its description in

the most current management plan. Any discrepancies must be explained by the borrower.

## **7.11 BORROWER REPORTING OF RENTS**

Borrowers must report to the Agency on *Form RD 3560-29, Notice of Payment Due Report* all rents, overages, and surcharges collected. This form shows the occupancy status of each unit, rents collected from each tenant, and borrower payment and agency tracking of overage. Overage is the amount by which total rental payments paid or to be paid by the tenants of a project exceed the total basic monthly charge (see paragraph 7.4 of this chapter). Borrowers identify any overage collected on *Form RD 3560-29*. Overage is returned by the borrower to the Agency. Overage for an account with an interest credit agreement is charged to the account as additional interest on the initial loan. Tenant contributions must be applied first to rental charges rather than to miscellaneous charges and fees, such as late fees.

### **A. Agency Tracking of Overage**

The Loan Servicer must enter overage that is reported and returned by the borrower with *Form RD 3560-29* into the online payment system. Overage is coded for Agency accounting purposes depending upon from whom it is collected as follows:

- **Overage Type 1:** Rents paid by tenants in a Plan II project that are in excess of the basic rent up to the note rate rent.
- **Overage Type 2:** HUD contract rents in a Section 8/515 project with interest credit that are greater than the one or two percent reduced rate rent, up to the note rate rent.
- **Overage Type 3:** HUD contract rents in a Section 8/515 project with interest credit that are greater than the note rate rent. These rents go into the project reserve as excess funds.

For additional information on how the Agency handles overage, please refer to the Automated Multi-Family Housing Accounting System (AMAS) manual.

### **B. Payment of Overage for Multi-Family Housing Projects with Interest Credit and No Rental Assistance**

When 30 percent of a tenant's adjusted income exceeds the basic rent, the difference they pay in rent between the basic rent and the note rate rent is referred to as overage. This is returned by the borrower to the Agency as extra interest payment on the loan. Exhibit 7-4 provides an example of how overage is paid.

<b>Exhibit 7-4</b>			
<b>Example—Overage Payments at Sunny Brook</b>			
Basic Rent: \$350		Note Rate Rent: \$400	Utility Allowance: \$0
Tenant	30% of Adjusted Monthly Income	Rent Payment	Overage Payment
Anderson	\$200	\$250	\$0
Reese	\$350	\$350	\$0
Armour	\$375	\$375	\$25
Bishop	\$400	\$400	\$50
Grate	\$400	\$400	\$50

### **C. Payment of Overage for Section 8/515 Projects**

It is Agency policy that any funds paid by HUD are paid on behalf of a tenant. Therefore, the Agency does not consider any HUD Section 8 payments as excess funds until any benefits provided by the interest credit agreement are recovered. Borrowers must collect overage for their tenants as follows:

#### ***1. For Section 8/515 Projects with a One Percent or Two Percent Reduced Interest Rate***

In 100 percent Section 8/515 projects when the HUD contract rental rate is more than the one or two percent reduced interest rate and is either equal to or less than the note rate rent, overage will be paid to the Agency in an amount equal to the difference between the HUD contract rental rate and the 1 or 2 percent reduced interest rate. The overage is reported as Overage Type 2.

In 100 percent Section 8/515 projects when the HUD contract rental rate is greater than the note rate rent, the difference between the one or two percent reduced interest rate and the HUD contract rate will be paid to the Agency and reported as overage Type 2. The amount equal to the difference between the HUD contract rental rate and the Agency note rate rent will be deposited in the reserve account as excess income.

In 100 percent Section 8/515 projects when the HUD contract rental rate exceeds the note rate rent, the borrower must use *Form RD 3560-29* to document the required deposit in the reserve account, even though the form indicates Plan II only.

Exhibits 7-5 and 7-6 provide examples of how overage is determined in Section 8/515 projects.

<b>Exhibit 7-5</b>		
<b>Determining Overage in Section 8/515 Projects With 1 or 2 Percent Reduced Interest Rate—Examples</b>		
<i>Example 1</i>		
<b>1 or 2 Percent Reduced Interest Rate</b>	<b>HUD Contract Rent</b>	<b>Note Rate Rent</b>
\$250	\$300	\$375
\$50 difference paid to Agency as overage type 2		\$75 interest credit
<i>Example 2</i>		
<b>1 or 2 Percent Reduced Interest Rate</b>	<b>Note Rate Rent</b>	<b>HUD Contract Rent</b>
\$250	\$375	\$400
\$125 difference paid to Agency as overage type 2		\$25 required to be placed into reserve
Note: If the HUD contract rent and the Agency 1 or 2 percent reduced interest rent are the same, then the first column would not apply.		

## ***2. For Section 8/515 Projects with Full Interest Credit***

In Section 8/515 projects the overage is the difference between basic rental rate and the note rate rent including the income from HUD. The overage will be reported as Type 3.

In the cases where the HUD contract rental rate exceeds the note rate rent the difference is excess income and will be deposited in the reserve fund. The borrower should use *Form RD 3560-29*, Part I, items 23 through 29, to document the required deposit in the reserve account.

<b>Exhibit 7-6</b> <b>Determining Overage in Section 8/515 Projects</b> <b>With Interest Credit—Examples</b>		
<i>Example 1</i>		
<b>Basic Rent</b>	<b>HUD Contract Rent</b>	<b>Note Rate Rent</b>
\$175	\$300	\$375
\$125 difference paid to Agency as overage type 3 by Section 8 tenants and subject to overage type 1 by non-Section 8 tenants		\$75 interest credit and subject to overage Type 1 from non-Section 8 tenants
<i>Example 2</i>		
<b>Basic Rent</b>	<b>Note Rate Rent</b>	<b>HUD Contract Rent</b>
\$175	\$375	\$400
\$200 difference paid to Agency as overage by Section 8 tenants and subject to type 1 overage by non-Section 8 tenants		\$25 required to be placed in reserve account as excess income

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## SECTION 4: RENT CHANGES

### 7.12 OVERVIEW

All borrowers, including those using HUD Section 8 contract assistance, must obtain prior Agency approval for a rent increase. Changes in rental rates will apply to all units in a project. Rent change requests for multi-family housing projects with no HUD subsidy are typically submitted and reviewed at the same time the borrower submits their annual budget for approval. Rent changes in Section 8/515 projects resulting from automatic rent increases by HUD must also be reviewed and must not automatically be approved. For any project, only the amount of rent necessary to cover project expenses must be approved. This section covers rent changes in projects without HUD subsidies, then changes in projects with HUD subsidies.

### 7.13 CHANGES IN RENTS AND UTILITY ALLOWANCES IN PROJECTS WITH NO HUD SUBSIDIES [7 CFR 3560.205]

It may be necessary as operating costs and/or revenues in a project fluctuate for the borrower to request Agency approval to effect a rent change. Exhibit 7-7 shows the timeline for borrower submission and Agency review of rent change requests.

#### A. Switching to Plan II Projects

If the project for which the rent increase is being requested is not a Plan II project, the Field Officer must first encourage the borrower to change their loan status to Plan II. This can be done by having the borrower execute a new *Form RD 3560-9*. Switching to Plan II may result in the rent increase becoming unnecessary.

If switching to Plan II is not possible or relevant, the borrower must submit a rent change request at the time of the annual budget submission and give proper notification to tenants of the rent change request.

<b>Exhibit 7-7</b> <b>Rent Increase Request Timeline</b>	
<b>Day</b>	<b>Event</b>
<u>90 days</u> prior to end of fiscal year <i>October 1*</i>	Borrower submits budget documents to Agency and notifies tenants of requested rent increase. <ul style="list-style-type: none"> <li>• Tenants have <u>20-day</u> comment period to get back to the borrower (<i>October 5</i>).</li> <li>• Agency has <u>45 days</u> total to review the budget (<i>November 15</i>).</li> </ul>
<u>60 days</u> prior to end of fiscal year <i>October 31</i>	Agency provides notice to the borrower of budget approval or rejection.** <ul style="list-style-type: none"> <li>• If the budget was denied, the borrower may submit additional information to address deficiencies within <u>10 days</u> (<i>November 10</i>).</li> <li>• Agency has <u>20 days</u> to review the additional information (<i>November 30</i>).</li> </ul>
<u>30 days</u> prior to end of fiscal year <i>November 30</i>	Final approval or rejection of the budget. <ul style="list-style-type: none"> <li>• If the budget is approved, tenants must have <u>30 days'</u> notice before the rent increase takes effect. (If the notices given to tenants at the outset stated the amount of the effective increase, then notice has been given.)</li> <li>• If the rent increase is denied, the borrower may submit a revised budget at previously approved rents with expenditures acceptable to the Agency. In the absence of such a revised budget, the prior year's budget will go into effect.</li> </ul>
Beginning of project's fiscal year <i>January 1</i>	New budget and rent increase take effect.
<p>* The dates provided are for a sample project with a fiscal year that begins January 1. For projects with different fiscal years, adjust accordingly.</p> <p>** If the borrower submitted the budget on time and has not been notified by the Agency of any deficiencies by this time, the budget is considered approved unless it is not eligible for automatic approval (see Chapter 4, Paragraph 4.28).</p>	

## **B. Timing of Rent Change Request**

Borrowers must submit to the Agency rent and utility allowance change requests in conjunction with the annual budget submission. To provide the necessary time for a tenant comment review period, the borrower must notify the Agency of the amount of the rent change request that they intend to submit with their annual budget 90 days prior to the effective date of the rent change. At the same time, the borrower will provide their tenants with a notice of the amount of the rent change request that they intend to submit to the Agency.

## **C. Rent Change Requests under Special Circumstances**

The Loan Servicer may accept borrower requests for rent or utility allowance changes at times other than with the annual budget submission under special circumstances where a change is necessary to preserve the financial integrity of a project and the financial



distress is due to circumstances beyond a borrower's control. Such circumstances might be in the event of a natural disaster or when work-out procedures are necessary.

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a special note rent (SNR), which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent. The requirements for receiving an SNR are established under 7 CFR 3560.454.

#### **D. Annual Utility Allowance Reviews**

The borrower should review utility allowances on an annual basis to determine whether any changes have to be made. The borrower should indicate no changes to utility rates in the comment section of the budget narrative.

#### **E. Tenant Notification and Comments**

At the same time the borrower submits the initial notice to the Agency that they intend to submit a rent change request, the borrower will send or deliver notices to each tenant in the project notifying them of the rent change request that will be submitted to the Agency with their annual budget. **Attachment 7-A** provides an example of such a notice. The borrower must also post this notice in a common area frequented by the tenants, such as the laundry room or near the mailboxes.

The notice must notify tenants that they have 20 days to provide their comments to the Agency. If during this time the Agency receives any tenant comments, these must be immediately forwarded to the borrower, with the identity of the tenant protected. This can be done by either paraphrasing the comments for the borrower or by removing any identifying information from the correspondence received from the tenant and forwarding it on to the borrower.

After the 20-day comment period, the Agency must notify the borrower of approval or rejection within 10 days.

#### **F. Documentation**

The borrower must fully document any rent change request. Requests for a rental charge change must be based on a realistic projected budget for the interim year or the ensuing full year. The borrower must provide to the Agency the information identified in Exhibit 7-8 with the rent or utility allowance change request.

**Exhibit 7-8****Information Required to Document Rent or Utility Allowance Change Request**

1. Form RD 3560-7 must be used to reflect the project's financial needs for the year and thereby rental charge requirements. A narrative cover letter must be included explaining why the rent change is necessary. A new operating budget for the fiscal year must show:
  - Currently approved budget at old rents;
  - Actual income and expenses to date;
  - Proposed budget at proposed new basic rents; and
  - Proposed budget at proposed new note rate rents (if applicable).
2. Actual utility costs. Refer to Chapter 4, Paragraph 4.24 C for a description of the information required to document utility allowance change requests.
3. Additional documentation. Additional documentation must be attached to *Form RD 3560-7* in accordance with the instructions to these forms as evidence of the need for the rent or utility allowance change.
4. Comparable market rents.
5. Other information. Any other information the borrower believes is necessary to justify the proposed shelter cost change.

The narrative attached to the budget form must clearly explain the necessity for the change request and the Loan Servicer must analyze the supporting documentation to the budget and *Form RD 3560-7* to see if it supports the request. For example, if the rent increase is due to increased taxes, then the Field Officer should look for copies of tax increase notices in the budget documentation. If the rent increase is due to an increase in general operating expenses, the Field Officer must review those expenses for reasonableness. Chapter 4 discusses reasonableness and how a budget should be reviewed for acceptability.

**G. Agency Responsibility*****1. Reviewing the Rent Change Request***

When the borrower submits a budget with a rent or utility allowance change request, the Agency must respond to the borrower within 30 days. If the Agency does not contact the borrower within 30 days, the borrower may assume that any rent change request of \$25 or less has been automatically approved.

***2. Circumstances in which the Agency Will Not Approve a Rent Increase***

The Loan Servicer must not approve a rent increase under the following circumstances:

- The borrower is able but unwilling to comply with program requirements. Such a borrower has ignored repeated requests from the Loan Servicer to take servicing actions by a specified deadline.
- If the borrower is in default of the Agency loan agreement and does not have an Agency-approved work-out plan, or is not in compliance with an Agency-approved workout plan.
- There are sufficient project funds under the existing rents to meet project operating expenses, and the borrower is not able to justify the higher rents. Such a condition is established when the project budget shows that income meets expenses at current rent levels.
- The project is operated on a profit basis, and the rent change would result in rents higher than what tenants can afford. This condition is established by comparing rents with 30 percent of tenant adjusted incomes. If it is shown that tenants would be paying in excess of 30 percent of their adjusted incomes as new rents and the increase is not necessary to meet projected costs, then the increase must not be approved.

### ***3. Rejection of Rent Change Request***

If the Loan Servicer rejects the change request, the borrower must be notified and be provided with appeal rights.

### ***4. Effective Dates of Change***

The effective dates of any approved changes will coincide with the start of the project's fiscal year or the start of the season for labor housing projects. If the Agency approves the rent, or if a borrower cannot document that a tenant received a recertification notice and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants will continue to make net tenant contributions to rent based on their most recent tenant certification. The borrower must remit to the Agency full overage as if the tenant was paying the note rent until the tenant is recertified.

For allowance increase request on which comments were solicited, the borrower must deliver a notice to tenants announcing the rent or utility allowance increase to be effective 30 calendar days from the date of the notification, unless the rent increase will be the same as what was stated in the initial notice to the tenants.

If the figure is revised downward, the borrower must notify the tenants of their new rents prior to the first day of the month in which the new rent amounts are due. However, the borrower does not have to give 30 days' notice of the new rents in this case.

## 7.14 RENT CHANGES FOR UNITS RECEIVING HUD SECTION 8 ASSISTANCE [7 CFR 3560.207]

The Agency has the responsibility to review and approve project budgets on an annual basis based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer will not take into account HUD's automatic annual adjustment for Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.

### A. Reviewing Budgets with HUD Subsidies

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have a three-column budget in properties with HUD Section 8 contracts. Exhibit 7-9 depicts how many columns are required in the budget, depending upon the project type.

Exhibit 7-9 Reviewing Budgets with HUD Subsidies	
Project Type	Columns Needed in Budget
<ul style="list-style-type: none"> <li>• 100 percent Section 8/515 with no interest credit; HUD contract rent rate is equal to basic rent</li> <li>• 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic rent and less than note rate rent</li> <li>• 100 percent Section 8/515 without interest credit; HUD contract rent is greater than note rate rent</li> <li>• Less than 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic and less than or greater than note rate rent</li> </ul>	<ul style="list-style-type: none"> <li>• One column only showing HUD contract rent</li> <li>• Three columns showing basic rent, HUD contract rent and Agency note rate rent</li> <li>• Two columns showing HUD contract rent and note rate rent; difference is excess funds and deposited into reserves</li> <li>• Three columns showing basic rent, HUD contract rent and Agency note rate rent</li> </ul>

### B. Excess Rents

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 7-9, the borrower may be told to deposit the difference between the Agency approved note rate rent and the higher HUD-authorized rate into the reserve account. The manager or borrower must use *Form RD 3560-29* to document the required deposit in the reserve account.

If excess HUD rents accumulate in the reserve account beyond the sum shown in the borrower's loan agreement or resolution, the Loan Servicer may reduce or cancel the interest credit on the project. The Agency may reinstate interest credit whenever HUD rent should become lower than the Agency note rate rent.

Before depositing excess funds in the reserve account, the borrower may have to collect overage. Paragraph 7.11 of this chapter provides the details on how this is done. Whether overage is collected and a project is subject to cancellation of interest credit depend upon the issuance date and execution date of the project's interest credit agreement.

Certain early versions of the interest credit agreement do not have a legal basis to support the Agency's policy to cancel interest credit or collect overage to offset interest credit. Each Section 8/515 project needs to be categorized according to the issuance date and execution date of the project's interest credit agreement on *Form FHA 444-7* or its successor *Forms FmHA 444-7* and *RD 3560-9*. Exhibit 7-10 provides a description of the rules that apply to each interest agreement form.

## **7.15 MONITORING COMPLIANCE**

The Loan Servicer will monitor compliance with the requirements of the rent and occupancy charge during supervisory visits, through monthly documentation submitted by the borrower, and at budget time.

### **A. Supervisory Visits**

The Loan Servicer must check project files to ensure that these files correspond with information provided to the Field Office. In addition, the Loan Servicer must ask the tenants about the amount of rent and security deposits they pay and the method of payment to make sure that the borrower is actually implementing the procedures described in the management plan.

If a borrower implements an unauthorized rent or utility allowance charge, the Agency will require the borrower to roll back rents to the last authorized rent charge, and the borrower must reimburse tenants for any unauthorized rents collected.

<b>Exhibit 7-10</b> <b>Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account</b>		
<b>Form</b>	<b>Executed Before October 27, 1980</b>	<b>Executed On Or After October 27, 1980</b>
FHA 444-7, dated 11/17/69 and 7/27/72	No basis to cancel or reduce interest credit, collect overage, or deposit excess funds in the reserve account unless the borrower agrees.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 444-7, dated 10/13/77	<ul style="list-style-type: none"> <li>• If first, second, fourth or fifth block of paragraph 2 checked, no legal basis to cancel or reduce interest credit, collect overage, or deposit excess funds into reserves.</li> <li>• If the third block of paragraph 2 is checked, no legal basis to cancel or reduce interest credit, unless borrower agrees. However, there is legal basis to collect overage and deposit excess funds to reserves and/or apply it on the loan.</li> </ul>	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 1944-7, dated 11/29/82		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.
FmHA 1944-7, dated 4/85		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.

**B. Monthly Borrower Submissions**

The Loan Servicer must carefully check *Forms RD 3560-29* and *RD 3560-8*, to make sure that the correct rents are being charged according to income.

**C. At Budget Time**

The Loan Servicer must carefully review the budget to ensure that income reflects rents collected and that expenses are reasonable and justify the rents being charged.

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## **SECTION 5: RENTS FOR LABOR HOUSING PROJECTS**

### **7.16 OFF-FARM LABOR HOUSING**

#### **A. Rent Structure**

Tenants in Off-Farm Labor Housing are required to make a monthly rent payment in the amount equal to:

- In units with rental assistance, 30 percent of their income for rent in accordance with the amount calculated annually on *Form RD 3560-8*; or
- The approved rent, when rental assistance is not available.

#### **B. Establishing a Basic Rent at the Property**

For each Off-Farm Labor Housing project, the Agency will establish a basic rent in accordance with the project's annual operating budget. This basic rent will be equal to the project's operating expenses, plus the debt service payment based on the project's one percent interest rate, as approved by the Agency.

### **7.17 ON-FARM LABOR HOUSING**

Rents for On-Farm Labor Housing should be in accordance with the employment agreement between the tenant and the borrower. In general, rents should not be required for projects assisted through the On-Farm Labor Housing program. Borrowers who choose to charge rents at On-Farm Labor Housing properties must comply with the rent setting and adjustment procedures established for Section 515 projects in this chapter.

On-farm labor housing borrowers are not required to charge security deposits, but if they do so, they must follow the terms described in Section 2 of this chapter.

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## ATTACHMENT 7-A

### NOTICE TO TENANTS (MEMBERS) OF PROPOSED RENT (OCCUPANCY CHARGE) AND UTILITY ALLOWANCE CHANGE

\_\_\_\_\_  
Date Posted

You as a tenant (member) are hereby notified that, subject to approval by Rural Development, rents (occupancy charge) and utility allowances may be changed effective \_\_\_\_\_. (at least 60 days from this posting or other timeframe if required by state law.)

\_\_\_\_\_ [Project Owner's Name] has filed a request for approval of a change in the monthly rent (occupancy charge) and/or utility allowances as of the [name of the apartment complex] with Rural Development of the U.S. Department of Agriculture for the following reasons:

- 1.
- 2.
- 3.
- 4.

Planned rent (occupancy charge) changes are as follows:

Unit Size	Present Rent (Occupancy Charge)		Proposed Rent (Occupancy Charge)		Amount Changed
	Basic	Note Rate	Basic	Note Rate	
Efficiency					
1-Bedroom					
2-Bedroom					
3-Bedroom					
4-Bedroom					
5-Bedroom					

Planned utility allowance changes are as follows:

Unit Size	Present Utility Allowance	Proposed Utility Allowance	Amount Changed
Efficiency			
1-Bedroom			
2-Bedroom			
3-Bedroom			
4-Bedroom			
5-Bedroom			

(Use the following paragraph when the tenant is receiving rental assistance)

Since you receive rental assistance, your contribution toward your rent (occupancy charge) and utilities will NOT be changed UNLESS your income and/or household composition changes.

All materials justifying the proposed changes have been reviewed by Rural Development and will be made available to you and other tenants (members) to inspect and copy at \_\_\_\_\_ [location address] on the following dates and times:

\_\_\_\_\_.

You may submit comments or objections in writing to Rural Development during the 20-day period immediately following the posting of this notice. Comments or objections should include reasons or information you feel should be considered by the Agency. Your comments or objections must be filed prior to \_\_\_\_\_ (insert date) with \_\_\_\_\_ (insert loan servicer's name) located at \_\_\_\_\_ (insert complete address of office).

These comments will be reviewed by Rural Development and forwarded to the official who will decide if the change(s) should be approved.

Each tenant (member) will be notified in writing of any Rural Development's decision to deny or modify the change. If no further notification, the change will be implemented as stated in this notice. The approved rents and utility allowances will then be effective upon the effective date given above. **If you receive Rental Assistance, and the portion of the rent that you pay will either remain the same or decrease, you will not receive another written notice of an increase in rent.** If you receive Rental Assistance, and the portion of the rent that you pay will increase, you will receive a \_\_\_-day (insert 30 or 60 days, whichever is applicable).

Signed:

\_\_\_\_\_  
Borrower/Borrower's Representative

## CHAPTER 8: RENTAL SUBSIDIES

### 8.1 INTRODUCTION

Rental subsidies are deep subsidies that enhance the affordability of rents in a project. Each year, the Agency has available a limited number of Agency-funded rental assistance units that can be allocated to new or existing Agency-financed multi-family housing projects. The Agency also encourages the use of non-Agency rental subsidies in multi-family housing projects as a way to reduce tenants' rents.

Because rental subsidies are limited, it is important that they be allocated to borrowers and distributed to tenants in a fair and equitable manner. Consequently, the Agency has developed rules that must be followed in the distribution and administration of rental subsidies. This chapter presents the program rules and procedures for allocating and administering rental subsidies in multi-family housing projects, including Farm Labor Housing projects. It covers not only Agency-funded rental assistance, but U.S. Department of Housing and Urban Development (HUD) and other types of subsidies as well.

For purposes of this chapter, the term "tenant" also means "member," and "rental assistance" is reserved for use in describing Agency-financed rental subsidy.

### 8.2 AUTHORIZED RENTAL SUBSIDIES [7 CFR 3560.252]

#### A. Project-Based Rental Subsidy

The Agency may authorize the use of project-based rental subsidies in addition to interest credit for multi-family housing projects. These rental subsidies may take the form of:

- **Agency-funded rental assistance.** This is a project-based subsidy program available to very low- and low-income tenants in Agency-financed multi-family housing.
- **HUD Section 8 assistance.** This project-based subsidy is administered by HUD and was used extensively with Agency-financed housing from the mid-1970s to the early 1980s.
- **Private rental subsidy.** This is a subsidy program whereby the project owner(s) or others enter into an agreement with the Agency to provide and fund subsidy to tenants of the project on approximately the same basis as the Agency-funded rental assistance program. In some instances, the agreement may include a limit on the number of units and a per-unit ceiling on the amount of assistance.
- **State or local rental subsidy.** Such subsidy is provided and funded by some states and available to borrowers to assist tenants on approximately the same basis as the Agency rental assistance program. The assistance is in the form of a contract between the borrower and the state and has the Agency's concurrence.

- **Operating subsidy for off-farm migrant farmworker projects.** Section 521 Agency rental assistance funds may be used as operating assistance in migrant farmworker projects financed under 514 or 516 to reduce operating costs so that rents may be set at rates affordable to low-income migrant farmworkers.

## **B. Tenant-Based Rental Subsidies**

HUD Section 8 Rental Certificates or Rental Vouchers may be accepted by borrowers in Agency-funded multi-family housing. These subsidies are administered by HUD or others authorized to administer the program such as a State Housing Finance Agency or the local public housing agency. Projects accepting tenants who use such vouchers assigned by a local public housing agency will also comply with any requirements imposed by that agency.

## **C. Multiple Subsidies**

More than one type of subsidy may be used in a project. The rental subsidy that the tenant is receiving must be less than the full amount of Agency rental assistance for which the tenant would qualify. In such cases, the Agency may provide the difference between the subsidy received by the tenant and the amount of Agency rental assistance for which the tenant qualifies.

There are special tenant codes under Part II, item 6 of the electronic MFIS Tenant Certification to denote what types of subsidy, if any, a tenant is receiving, and whether the tenant is receiving full or partial subsidy from a source other than the Agency.

## SECTION 1: ALLOCATION OF AGENCY RENTAL ASSISTANCE

### 8.3 AGENCY-FUNDED RENTAL ASSISTANCE

The objective of the Agency rental assistance (RA) program is to reduce rents paid by low-income households. RA is the portion of approved shelter cost (rent and utilities) paid by the Agency to the borrower on behalf of a tenant to compensate for the difference between the approved shelter cost and the monthly tenant contribution as calculated on *Form RD 3560-8, Tenant Certification*. When the household's monthly gross tenant contribution is less than the approved utility allowance that is billed directly to and paid by the tenant, the owner will pay the household that difference.

If a prospective tenant with a HUD voucher or other subsidy applies for occupancy and the project has RA or project-based subsidy, the RA or project-based subsidy takes precedence. RA may only be provided to tenants who are income eligible and residing in eligible units. There are four types of RA:

- **Renewal RA** is RA that replaces RA agreements contracts expiring because the obligated funds under the agreement have been fully disbursed. Because the Agency wishes to protect tenants currently benefiting from RA, replacement of RA contracts receive first priority for funding from the Agency.
- **Servicing RA** is RA that increases the number of RA units in a project resulting in an initial RA agreement or an amendment to an existing agreement with a borrower.
- **New construction RA** is RA to accompany new units of multi-family housing.
- **Incentive RA** is RA that is used to help preserve multi-family housing projects as part of the prepayment process. For information about the prepayment process, see HB-3-3560, Chapter 15.

### 8.4 ALLOCATION AND DISTRIBUTION OF AGENCY RA [7 CFR 3560.257]

#### A. Allocation of RA to the States by the National Office

RA is allocated to the states on an annual basis by the National Office and in an amount based on Congressional appropriations. The National Office uses RD Instruction 1940-L to allocate the RA and to provide guidance to the states on how to distribute the RA among projects.

Before the beginning of the fiscal year, the National Office sends out a survey to each state requesting summary data on the need for RA in each state. These data are used to allocate replacement and servicing RA. New construction RA is allocated to each state based on a formula.

## B. Prioritization of RA

In the absence of other guidance from the National Office, states will use the following priorities to allocate RA within the state:

- **Replacements units.** First priority will be for replacing RA units that are expiring.
- **New construction.** Second priority will be for RA to accompany new construction.
  - ◇ RA units will be allocated to those projects that are selected for funding under the Notice of Funding Availability (NOFA) system and in accordance with the scoring and ranking system described in Chapter 4 of HB-1-3560.
  - ◇ For farm labor housing projects, RA units will be allocated by the National Office from the National Office reserve on a case-by-case basis at the time the projects are considered for funding at the National Office level.
- **Servicing assistance.** Third priority is for RA for existing multi-family housing projects that have requested servicing RA by checking the appropriate box on the budget *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*.

Incentive RA is not allocated by priority. The National Office usually allocates incentive RA from a special set-aside of funds.

## 8.5 PROJECT ELIGIBILITY FOR AGENCY RA [7 CFR 3560.254]

To be eligible for RA, a project must be designated as one of the following types according to the loan agreement:

- A Plan II interest credit project. If a project is not currently a Plan II project, it may be possible to change to Plan II and thereby become eligible. Exhibit 8-1 lists which types of projects may switch to Plan II and which may not.
- An off-farm labor housing project. Off-farm labor housing projects that are financed with grants only are not eligible.
- A project financed with a direct or insured Rural Rental Housing Loan approved prior to August 1, 1968. To be eligible, the project must be operated under an interest credit agreement that identifies the housing project as a Plan RA project.
- A project funded by multiple sources, including Agency financing, for which the loan must be a Plan II interest credit loan.



<b>Exhibit 8-1</b>			
<b>Project Eligibility for Rental Assistance</b>			
<b>Project Type</b>	<b>Eligible</b>	<b>Not Eligible</b>	<b>Can Convert to Plan II</b>
On-Farm Labor Housing		X	NO
Off-Farm Labor Housing	X		
For Profit		X	YES
Plan I		X	YES
Plan II	X		
Section 8/515 with no interest credit		X	YES
Section 8/515 with interest credit reduced by 1%		X	YES
Section 8/515 with interest credit reduced by 2%		X	YES
Section 8/515 with full interest credit	X		

## 8.6 PROCESSING RA OBLIGATIONS [7 CFR 3560.255]

The State Director or a delegated member of the staff approves or disapproves RA requests. *Form RD 3560-51, Obligation Fund Analysis*, is the form that obligates the RA.

When reviewing RA requests, the Loan Servicer must consider the following questions:

- Is the project/unit eligible for RA? The project must meet the requirements specified in Section 8.5.
- Does the project need the RA? The supporting documentation from the borrower must show that there are tenants or applicants who are eligible for the RA.
- Is the RA available for distribution? The state must have the RA units available.

How an RA request gets processed depends upon whether the assistance is for replacement RA, servicing RA, or new construction RA.

### A. Renewal and Servicing Rental Assistance

#### 1. Tracking Usage of Agency-Funded RA

The Loan Servicer inputs the information provided by the borrower on *Form RD 3560-29, Notice of Payment Due Report* into the Automated Multi-Family Housing Accounting System (AMAS). Using AMAS, the Loan Servicer should track the use of RA obligations and ensure that RA obligations are not disbursed or credited to a borrower's account in excess of the RA obligation. Quarterly and annually, a report is issued by the St. Louis Office that provides the Loan Servicer with an RA payment and obligation status report for each project.

The Field Office must monitor statewide RA usage so that it can be reported as expiring and needing replacement when the annual survey is sent out from the National Office ascertaining the need for replacement RA.

## ***2. Processing Renewal RA***

Renewal RA must not be awarded in an amount that is more than necessary to cover existing expiring contracts. For example, if a 24-unit project has only 18 units of RA that are expiring, the State Director may not award the project more than 18 units of RA.

To the extent that sufficient Federal funds are available, the Agency will automatically renew expiring RA agreements at the existing number of units.

If there is no renewal RA available to give to the borrower due to a lack of Congressional appropriations, the Loan Servicer will inform the borrowers that they must notify the affected tenants of their increased rents and give them the option of quitting their leases with no penalties.

## ***3. HUD Section 8 Housing Assistance Payments***

For properties that receive project-based HUD Section 8 assistance, borrowers must provide copies of their Housing Assistance Payments (HAP) contracts to the Loan Servicer. The Loan Servicer must monitor these contracts, particularly their expiration dates.

## ***4. Servicing RA***

Borrowers apply for servicing RA by checking a box on the project budget *Form RD 3560-7*, indicating a need for servicing units and certifying that they have looked elsewhere for other rental subsidies. To allocate servicing units to a project, the Loan Servicer must verify that the project is eligible and:

- Existing tenants are paying more than 30 percent of their incomes in rent; or
- There are vacancies in the project and evidence that shows that there are very low-income tenants who would occupy the housing if there were RA units available. Such evidence must be in the form of market data and/or waiting lists.

## **B. New Construction Rental Assistance**

New construction RA is requested with the initial application. The following requirements must be met for the Agency to consider awarding new construction RA:

- The number of RA units requested must be based on the market data for the area, the proposed rental rates as reflected in a budget for the project, and the income levels of the prospective tenants; and
- If the RA is going to be part of a project funded by a participation loan, the Agency participation rate needs to be at least 25 percent of the total development cost.

Chapter 4 of HB-1-3560 provides further details on processing new construction RA.

### **C. Approval and Processing Actions for FY 04 RA Obligations**

The Fiscal Year 2004 appropriation language has established a set term of 4 years for FY 04 RA obligations, only. Therefore, the following instruction should be used for completing *Form RD 3560-27, Rental Assistance Agreement*, regarding all FY 04 RA obligations.

- All FY 04 obligations will always need to have a separate *Form RD 3560-27*.
- Changes to the form include:
  - ◊ Above title: “Rental Assistance Agreement” add “Four Year.”
  - ◊ Section 8 (a): cross out “...individually and automatically upon total disbursement or credit to the borrower’s account” and insert “...four (4) years from       \*      , unless the funds are fully expended prior to that time.”
- If agreement is for the original obligation, enter the date the agreement is prepared. If the agreement is for units transferred, enter the date of the agreement from the original *Form RD 3560-27*.

For example, renewal obligation for Borrower A is obligated on April 6, 2004, and the *Form RD 3560-27* is signed on April 10, 2004. The expiration of the obligation will be April 10, 2008. If one unit of RA (from the FY 04 obligation) is transferred to Borrower B on August 15, 2005, then the *Form RD 3560-27* for Borrower B will have an expiration date of April 10, 2008, even though the borrower received the unit on August 15, 2005.

A servicing effort tracking item “FY 04 RA Obligations” has been established in MFIS to assist in the monitoring of FY 04 RA obligations. The National Office will be monitoring this tracking item to assure that funds are properly managed.

### **D. General Approval and Processing Actions**

When it has been determined that RA can be obligated, the Loan Servicer will prepare and distribute part III of *Form RD 3560-51* according to the instructions. *Form RD 3560-27*, will not be executed or amended until the obligation or transfer is processed by AMAS. The State Office will verify the obligation or transfer via the computer terminal on the day following the request.

When the State Office verifies that RA units have been obligated, it will forward a copy of *Form RD 3560-51* to the Loan Servicer. The Loan Servicer will complete *Form RD 3560-27* and attach the copy of *Form RD 3560-51* according to the instructions on the form. The *Form RD 3560-27* is then filed in the borrower’s active case file, and a copy is sent to the borrower.

If RA funds are available but cannot be provided due to a determination of ineligibility, the State Director will inform the borrower in writing of the reasons and provide the borrower information on appeal rights in accordance with 7 CFR Part 11. See paragraph 1.8 of Chapter 1 for an overview of the appeals process.

Loan applicants or borrowers determined to be eligible for RA as a result of an appeal or funding review will receive RA, if RA funding is available. If the funding is available, the applicant or borrower will receive it beginning with the month following the date of the appeal or funding review decision. If the funding is not available, the applicant or borrower will receive it beginning in the first month that RA funding becomes available.

When an RA request is denied because funds are not available from the state's allocation or the National Office reserve, the decision is not appealable.

## **E. RA Obligation Numbers**

The St. Louis Office uses obligation numbers to track RA obligations and undisbursed balances. See the AMAS manual for information on tracking RA obligations.

### ***1. Current Obligations***

When RA is approved, each RA obligation is assigned a six-digit RA obligation number as follows:

- First two digits represent the fiscal year in which the funds are obligated (e.g., 04, 05, 06, etc.);
- Second two digits represent the number of the RA obligation in sequential order for each fiscal year starting with 01 (e.g., 04-01, 04-92, 04-03, etc.); and
- Third two digits are coded 00 for all obligations.

For example, the fifth RA obligation made in fiscal year 2005 would be coded 05-05-00.

### ***2. Pre-1985 Obligations***

RA obligations obligated before 1985 were coded as follows:

- First two digits represent the fiscal year in which the initial obligation was made on the project (i.e., 78, 79, 80, etc.);
- Second two digits relate to the pre-Automated Multi-housing Accounting System conversion loan number to which the RA obligation was processed; and
- Third two digits indicate the number of modifications plus 1. (*Form RD 3560-27*, with two modifications on September 30, 1984, would be designated "03").

## 8.7 TERMS OF AGREEMENT [7 CFR 3560.258]

*Form RD 3560-27* is the document that sets out the terms of RA agreement between the Agency and the borrower.

### A. Terms of Agreement

Each *Form RD 3560-27* will be effective the first day of the month in which it is executed. If assistance is granted to a project under an appeal, the amount of the assistance will cover what is needed for an effective date retroactive to the first day of the month in which the assistance was denied, provided the borrower agrees to make any appropriate refunds to tenants who would have been entitled to RA during the retroactive term.

Starting in 2004, RA is obligated for 4-year terms. Previously, the Agency issued 5-year RA agreements. The agreement expires when the funds obligated for the RA units described in Section 1 of *Form RD 3560-27* are fully disbursed. This can be any time before or after the end of the agreement period. The Agency has in the past issued 20-year and 5-year RA agreements. If and when these are renewed, they are done so for 5-year or 4-year terms.

### B. When Agreements May Be Amended

Loan Servicers may amend RA agreements to:

- Add replacement units for the project to the agreement;
- Add or subtract servicing units assigned to the project through obligation, through transfer from another RA obligation, or as an incentive to avert prepayment;
- Reinstate a suspended RA obligation(s) to a new borrower in the same project after a voluntary conveyance or a foreclosure and a credit sale within the Multi-Family Housing program; or
- Transfer a suspended RA obligation(s) to a new borrower and a different project after liquidation of the project assets or after the loan is paid in full.

### C. Procedures for Amending Agreements

The following steps are taken to amend agreements.

- Any existing RA obligation executed prior to February 15, 1983, which will have a remaining obligation balance at the end of the 4-year, 5-year or 20-year expiration date stated in section 9 of the RA agreement, "Term of the Agreement," may be amended. The amended agreement will expire when the obligated funds are fully disbursed.

- For every replacement or modification of an RA agreement that occurs on or after May 1, 1985, the original and all copies of the affected RA agreement will be noted, assembled, and distributed by the Loan Servicer according to the form's instructions. When a *Form RD 444-27A, Amendment to RA Agreement* initiated prior to May 1, 1985, is replaced or modified, a new *Form RD 3560-27* will be prepared and distributed according to the form's instructions.
- The Loan Servicer must use the new form so that eventually all borrowers will be using the new form.

#### **D. Consolidating Agreements Prohibited**

Consolidation of RA agreements is allowed, if the fiscal year and the type of RA are the same.

#### **E. Replacing Expiring Obligations**

The Agency will renew all expiring obligations with obligations to the extent funds are appropriated. Expiring 20-year obligations will be replaced with current funding levels.

Expiring RA obligations and replacement RA obligations may run concurrently for a period of 30 to 50 days so any undisbursed obligation balance on the expiring RA agreement can be liquidated.

### **8.8 TRANSFERRING RA [7 CFR 3560.259]**

#### **A. Cases in which RA May Be Transferred**

The State Director may transfer RA in the following instances:

##### ***1. At Project Transfer***

When a project is transferred to an eligible borrower, the transferee may assume the transferor's unliquidated RA obligation(s).

##### ***2. Following Voluntary Conveyance or Foreclosure Sale***

When a project with RA is voluntarily conveyed to the Agency or acquired by foreclosure sale, the RA obligation will be automatically suspended under the borrower's name when the St. Louis Office processes *Form RD 3560-19, Status of REO Property*. The RA for these units will be held in suspension until the final disposition of the acquired property has been determined, at which time the RA will be transferred to a different Agency-financed project, if applicable or, if not, to another project at the State Director's discretion. During the inventory period, tenants will pay 30 percent of their incomes for rent. Tenants entitled to reimbursement for utilities will be paid from project income.

### ***3. Following Liquidation or Prepayment***

When a project with RA is liquidated through sale outside of the program or the loan is paid in full, the RA will be transferred to a different Agency-financed project, if applicable, or if not, to another project at the State Director's discretion.

### ***4. When Not Being Used After Initial Rent-Up***

RA that is not being used may be transferred with or without the borrower's consent or request. When RA is unused after initial rent-up and not needed because of a lack of eligible potential tenants in the area, all or a portion of it may be transferred by the State Director under the following conditions:

- The Loan Servicer recommends the RA transfer after reviewing documentation submitted by the borrower; and
- Available RA units remain unused after a one-year period since initial availability.

### ***5. When Not Being Used 6 Months or Later After the Initial Year of the Agreement***

If, after the end of the initial year of an RA agreement, the borrower has not used a portion of the RA units for any ensuing consecutive 6-month period, the State Director may transfer the number of unused units, minus at least one, to another project without the borrower's request. If the remaining unit(s) remain unused after an additional 6-month period, the State Director may authorize its transfer to another project. This would apply only if the current agreement is on *Form RD 3560-27*, and when:

- The Loan Servicer has reviewed the project occupancy list, waiting list, past RA usage, and any other data available and verified that there is no apparent RA need in the project;
- The State Director has notified the borrower at least 30 days in advance of the Agency's intent to transfer the RA units and has given the borrower appropriate appeal rights;
- If the borrower appeals the decision, the appeal is resolved in accordance with 7 CFR Part 11 before any transfer action is taken; and
- The transfer will take place in accordance with transfer procedures described in subparagraph C below.

### ***6. Due to an Unclosable Loan***

When RA will be unused because the loan to which it was obligated will not be closed or the RA agreement is not signed, the RA obligation may not be transferred except when the circumstances allow for the funds to finance the project to be transferred as well. However, if this situation occurs during the same fiscal year of obligation, the obligation must be canceled and reallocated immediately using current authorities.

Obligations from prior fiscal years must be canceled and will be lost unless the conditions allow the financing for the project to be transferred, in which case the RA may be transferred as well.

### ***7. In Response to a Disaster***

If a disaster renders a project temporarily or permanently uninhabitable, the RA may be transferred.

### ***8. Due to a Servicing Action***

The State Director will suspend RA in a project where the loan has been accelerated to the extent that no payments will be credited to the project's account. Interest credit will be credited to the project's account until the appeal period for the acceleration has expired. After the expiration of the appeal period, if it is determined that foreclosure will proceed, the interest credit will be canceled as of the last day of the month in which the appeal period expired. RA will be automatically suspended by the interest credit cancellation.

That portion of the monthly RA not needed to pay the project monthly installment and other charges, including any delinquencies, overage, and late fees may be processed and returned to the project operating account to maintain project operation. RA agreements expiring during the acceleration and appeal process may be renewed in order to continue payment of RA for this purpose, but only if a third party is managing the project to ensure the proper use of project funds.

After final disposition of the acceleration, expiration of the appeal, and redemption period of the defaulting borrower, the RA will be either transferred with a credit sale, transferred to a different project when the defaulting project is sold outside the program, or reinstated to the same project as follows:

- **Transferred with a credit sale.** If the project is sold through a credit sale to an eligible borrower within the program, the suspended RA should be transferred from the previous borrower's case number and project number to the new case number and project number. *Form RD 3560-55, Multi-Family Housing Transfer of RA*, will be attached to *Form RD 3560-19*.
- **Transferred to a different project.** If a defaulting project is sold outside the program, the RA must be transferred to a different project.
- **Reinstated to the same project.** When defaults are corrected, the State Director may reinstate the RA to the borrower's account.

The State Director will apprise the borrowers of their appeal rights under 7 CFR Part 11 upon notification of the pending suspension. The suspension will not be effective until these appeal rights have been exhausted.



## **B. Eligible Units**

In order to be eligible for RA, units must be eligible for interest credit in terms of habitability. Should a fire, natural cause, or other damage render a unit uninhabitable, the RA may be suspended during rehabilitation or it may move with a tenant to a temporary location in another project financed by the Agency.

## **C. Transferring RA for Displaced Tenants**

The State Director may transfer RA from one project to another eligible multi-family housing project to which a tenant is moving due to displacement as a result of prepayment, liquidation, or a natural disaster for that tenant's initial use.

The displaced tenant will be given first priority for an RA unit, regardless of other priorities for the RA, if all of the following conditions are met:

- The borrower is eligible to receive and administer RA.
- The tenant is eligible to occupy the project and to receive RA.
- The tenant has taken all of the following steps to ensure eligibility to receive priority for the unit of RA:
  - ◇ Placed on at least one waiting list for an Agency-financed project with a *Handbook Letter 201 (3560)*, *Letter of Priority Entitlement (LOPE)*.
  - ◇ Moved to the project as soon as the name was reached on a waiting list, even if it meant temporarily occupying an ineligible unit. The ineligible unit may not differ from the one for which the tenant is eligible by more than one bedroom.
  - ◇ Moved to an eligible unit as soon as one was available.
- The RA has not previously been transferred for the tenant's current displacement.

## **D. Process for Transferring**

Only the State Director may approve an RA transfer. RA may be transferred to any borrower with an RA eligible project according to the priorities established in this handbook or by the National Office. All or any portion of the units in an RA agreement with an undisbursed balance may be transferred from one project to another.

When the State Director approves an RA transfer, the Loan Servicer uses *Form RD 3560-55*, completed according to the instructions, to notify the St. Louis Office.

AMAS determines the per-unit value of the RA obligation being transferred by dividing the undisbursed balance of the RA obligation on the date the transfer is processed by the number of RA units in the agreement. The number of units being transferred times the per-unit value equals the total amount transferred. After the transfer

processes, the Loan Servicer must enter the dollar amount of the transfer in the remarks area of *Form RD 3560-55*.

RA units identified by different RA obligation numbers may be transferred. New RA obligation numbers should be assigned according to the instructions for *Form RD 3560-55* and as described in paragraph 8.6 E.

The Loan Servicer will complete *Form RD 3560-27* with *Form RD 3560-55* attached. These will be completed according to the instructions for each transferee. The transferee may use the transferred units effective the first day of the month in which the transfer is approved.

The Loan Servicer will amend the transferor's *Form RD 3560-27* by attaching a copy of *Form RD 3560-55* according to the instructions to indicate that a portion of the agreement has been transferred. When all RA units on a RA agreement have been transferred, the transferor's present agreement will be so documented.

## SECTION 2: ADMINISTRATION OF RENTAL ASSISTANCE

### 8.9 CORRECTIONS TO RENTAL ASSISTANCE PAYMENTS

#### A. Administrative Errors

The borrower is responsible for correcting any errors made in the administration of the RA program that are made by the borrower or the borrower's authorized management agent. Errors in computation or other unauthorized use of RA will require, at a minimum, the repayment of incorrectly advanced RA funds. Agency requirements regarding unauthorized assistance as established under 7 CFR part 3560, subpart O, apply whenever any RA has been incorrectly advanced.

If the error or unauthorized use of RA appears to be deliberate or intentional, the State Director will refer the case to the OGC. For more information on unauthorized assistance, see HB-3-3560, Chapter 9.

#### B. Canceling an RA Check

When an RA check needs to be canceled, such as when it is returned, or if the borrower must return an RA payment, the Loan Servicer will take the following steps:

- When the original U.S. Treasury check covering the RA is returned, prepare *Form RD 3560-53, Multi-Family Housing Cancellation of U.S. Treasury Check and/or Obligation*, and mail it to the multi-family housing unit in the St. Louis Office.
- When all or a portion of the monthly RA payment needs to be returned or if a refund of RA previously advanced is required, the borrower should submit a check made payable to the Agency to the Field Office, which will forward it to the multi-family unit in the St. Louis Office on *Form RD 3560-53*.

### 8.10 ASSIGNING RENTAL ASSISTANCE TO TENANTS AND APPLICANTS [7 CFR 3560.257]

Because RA is limited, the Agency has established procedures to ensure that it is distributed consistently and to the most needy households.

#### A. Eligible Households

Households which are eligible for RA are those:

- With very low or low incomes who are eligible to live in multi-family housing projects;
- With net tenant contribution determined in accordance with 7 CFR 3560.203(a)(2) that is less than the current basic rent for the unit;

- With tenant and co-tenant that is a U.S. citizen and/or a qualified legal alien as defined in 7 CFR 3560.11;
- Who meet the occupancy rules established by the borrower in accordance with 7 CFR 3560.155(e); and
- Who have a signed an unexpired *Form RD 3560-8* on file with the borrower.

To determine priority for assigning an available RA unit in an operational project, the borrower must update the latest *Form RD 3560-29* for the project as of the date the unit is available.

## **B. Priorities in Existing Projects**

When assigning available RA, borrowers must use the priorities identified in Exhibit 8-2.

<p style="text-align: center;"><b>Exhibit 8-2</b></p> <p style="text-align: center;"><b>Five Priorities for Assigning Rental Assistance</b></p> <ul style="list-style-type: none"> <li>• First priority is always to eligible very low-income tenants paying the highest percentage of their adjusted annual income in shelter costs.</li> <li>• Second priority is to very low-income applicants on the waiting list, considering the applicant's unit size and type needed.</li> <li>• Third priority is to eligible low-income tenants paying the highest percentage of their adjusted annual income in shelter costs.</li> <li>• Fourth priority is to eligible low-income applicants on the waiting list.</li> <li>• Final priority is to households that are residing in a rental unit for which they do not qualify on the basis of an occupancy waiver or other special approval situations</li> </ul>
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In order to provide RA to the third, fourth, and final priority categories, a borrower must fully document that either there are no very low-income households on the waiting list or fully document that occupancy by low-income households is limited as follows:

- For projects occupied on or after November 30, 1983, no more than 5 percent of the units in the project are occupied by low-income households; or
- For projects occupied before November 30, 1983, no more than 25 percent of the units in the project are occupied by low-income households.

Borrower documentation of these circumstances must be kept in the borrower's files and made available to the Loan Servicer upon request.

### **C. Assigning RA in Newly Constructed Units**

A borrower with RA units for a newly constructed project should accept applications for occupancy during the construction phase of the project, after the preconstruction conference has been held. The names of the applicants should be placed on a waiting list. During the initial rent-up period, the following priorities will apply:

- Until all the RA units have been assigned, a number of apartment units in the project equal to the number of RA units will be initially reserved for eligible tenants who qualify for RA, even if there are applications on other lists that applied earlier. Applications qualifying for RA will be considered according to the priority established for existing projects, by passing those applicants on the waiting list whose income is above the low-income limits for the area. The remaining units equal to the number of units that will not be subsidized with RA can be rented simultaneously to other applicants.
- If a substantial number of apartment units reserved to be used with RA units remain vacant after initial rent-up and the borrower could rent those units to applicants ineligible for RA, the borrower may request a transfer of unused RA units. However, applicants ineligible for RA cannot be selected to occupy units initially reserved to be used with RA until the unused RA units are transferred.
- If there are still vacant units, those applicants bypassed because they did not qualify for RA will be considered for occupancy on a first-come, first-served basis.

### **D. Continued Eligibility**

Eligible tenants receiving the benefits of RA may continue receiving such benefits as long as they remain eligible for occupancy, are eligible for RA under 7 CFR 3560.254(c)(2), and RA units are available. Thus, if tenants who have been receiving RA have an increase in income as that that they are now earning moderate incomes, they may continue to receive RA so long as the basic rent is 30 percent or more of their adjusted annual income.

### **E. Timing of RA Assignment**

Rental assistance is paid to the borrower on the first of the month based on the prior month's occupancy.

When a tenant who has been receiving RA vacates the project, the borrower must immediately assign that unit of RA to the next existing eligible tenant or applicant on the waiting list.

When a tenant receiving RA vacates before the end of the month and the borrower reassigns the RA, the Agency will provide RA for the newly designated tenant starting on the first day of the following month.

Applicants who move into the RA unit other than on the first day of the month will pay a prorated rent based on their rental assistance. For example, if basic rent is \$200 and the tenant's monthly contribution with RA will be \$120, the prorated share of the tenant's rent for the month if he or she moves in mid-month would be \$60.

When an RA unit is assigned to an eligible existing tenant on a day other than the first day of a month, the Agency will not provide rental assistance for the newly assigned existing tenant and the tenant will not pay reduced rental charges until the first day of the month following the assignment of the rental assistance.

When an eligible applicant moves into an RA unit on a day other than the first day of the month, the new tenant will pay a prorated rent based on the number of days they occupy the RA unit and the amount of rental assistance they will be receiving.

#### **F. Incorrectly Assigned RA**

Incorrectly assigned RA is viewed as unauthorized assistance and handled in accordance with the requirements established under 7 CFR part 3560, subpart O.

When the tenant has correctly reported income and household size but RA was assigned to a household in error, that tenant's RA benefit should be canceled and reassigned. Incidents involving incorrect reporting are handled in accordance with the unauthorized assistance requirements established under 7 CFR part 3560, subpart O.

Before the borrower notifies the tenant, the borrower or management agent shall review the case with the Loan Servicer. If the Loan Servicer verifies that an error has been made based on information available at the time the unit was assigned, the tenant will be given 30 days' written notice that the unit was assigned in error and that the RA benefit will be canceled effective on the next monthly rental payment due date after the end of the 30-day notice period. It should be noted that some states require a 60-day notice of rent increases, in which case the written notice must be extended to 60 days. The borrower will also notify the tenant in writing that:

- The tenant has the right to cancel the lease based on the error made by the borrower and the loss of benefit to the tenant;
- The RA granted in error will not be recaptured from the tenant; and
- The tenant may meet with management to discuss the cancellation and the facts on which the decision was based. If the facts are accurate and the tenant cannot produce further evidence proving eligibility for RA, there will be no appeal for the decision. If the tenant feels there is justification for further review, the borrower must give the tenant appeal rights under 7 CFR 3560.160.

The RA unit will be reassigned to the next eligible household, based on *Form RD 3560-29* from which the original priority was established, when the unit was erroneously assigned. The RA will not be retroactive unless the reassignment was based

on an appeal by the tenant. Retroactive RA may not exceed the project's remaining RA obligation balance.

Tenants may appeal determination of ineligibility for available RA under 7 CFR 3560.160. See paragraph 1.8 of Chapter 1 for information on the appeals process.

### **G. Dealing with Tenants Who Attempt to Receive RA Simultaneously in Two Different Projects**

A tenant may not receive RA in two different multi-family housing projects at the same time. If part of the household is occupying a unit and the tenant attempts to occupy a seasonal unit in another project, MFIS will identify the duplicate tenancy through the tenant's Social Security Number.

## **8.11 TENANT PAYMENTS [7 CFR 3560.256(d)]**

### **A. Rents**

Tenants receiving RA must pay the net tenant contribution toward rent, which will not exceed the higher of:

- 30 percent of monthly adjusted income, with an adjustment for any utility allowance; or
- 10 percent of gross monthly income, with an adjustment for any utility allowance.

### **B. Utilities**

The utility allowance for a project with RA is determined as it is for any other project. As for non-RA projects, the utility allowance is reviewed annually for accuracy and changes are made when necessary.

When the tenant is billed directly for utilities, rent paid by the tenant receiving RA will be the difference between the established utility allowance and the net tenant contribution as determined by 7 CFR 3560.203.

- Example: Assume a basic rent of \$250 and a utility allowance of \$50. Patty Duke's adjusted monthly income is \$400. Thirty percent of her adjusted income is \$120. Fifty dollars is deducted from the \$120 to allow her to pay her utilities, leaving her a net tenant contribution of \$70 for rent to the borrower. The Agency pays RA to the borrower on behalf of Patty Duke in an amount of \$180 to total the \$250 basic rent.

When utilities are paid by the household receiving RA and the net tenant contribution is less than the allowance for utilities, the borrower will pay the household the difference between the utility allowance and net tenant contribution.

- Example: Assume a basic rent of \$250 and a utility allowance of \$50. Jane Ronda's adjusted monthly income is \$160. Thirty percent of her adjusted monthly income is

\$48, which is less than the utility allowance. The Agency will pay \$252 in RA to the borrower to cover the \$250 basic rent and the extra \$2 that the borrower must provide to the tenant to allow her to meet the \$50 utility allowance.

In a project where the borrower pays all utilities, the tenant rent will be the net tenant contribution as per 7 CFR 3560.203 up to the approved rent for the rental unit being occupied.

- Example: In a project where the basic rent is \$300 and there is no utility allowance, RHS would pay the borrower \$180 for Patty Duke, who would pay the whole \$120 in rent, totaling the required rent payment of \$300. For Jane Ronda, the Agency would pay \$252 to the borrower in RA and Ms. Ronda would contribute her \$48 to make the total \$300 rent payment.



## **SECTION 3: OTHER RENTAL SUBSIDIES**

### **8.12 HUD RENTAL SUBSIDY [7 CFR 3560.260]**

The Agency encourages the use of HUD Section 8 vouchers.

#### **A. Project-Based Assistance**

Tenants in Section 8/515 units must pay rents and utility allowances in accordance with HUD requirements.

#### **B. Tenant-Based Assistance**

Families using vouchers must be initially eligible as per program rules [7 CFR 3560.152]. The public housing authority issuing the vouchers will be responsible for an annual examination of household income and family composition. The public housing authority will adjust the housing assistance payments made on behalf of the family to reflect any changes in the family's monthly adjusted income, size, or composition.

For tenants with HUD vouchers, the borrower must set the rent for each unit occupied by a voucher holder at the basic rent or the rent standard set by the public housing agency, whichever is higher. The borrower must remit the value of the voucher exceeding the basic rent up to the note rate rent to the Agency. The public housing agency distributing the HUD Section 8 subsidy may set the utility allowance.

Once a HUD assistance contract expires, recertification responsibility reverts to the borrower, and Agency form and income verification and certification requirements apply.

### **8.13 OTHER SOURCES OF RENTAL SUBSIDY [7 CFR 3560.260]**

The Agency may authorize other types of rental subsidies to be used in new or existing projects but will make no commitment to providing RA at the expiration of the project-based rental subsidy agreement from other sources.

#### **A. Agency Requirements for New Construction Projects Proposed with Non-Agency Rental Subsidy**

For the Agency to consider a new project with non-Agency rental subsidy, the applicants must demonstrate that:

- A market exists for the assistance and at income levels that would benefit from the subsidy being provided;
- Once the rental subsidy is no longer available, an adequate rental market exists for the project without assistance; and
- Tenants will not be displaced at the end of the subsidy agreement.

Applicants will specify how they intend to meet the above requirements through two documents: the memorandum of understanding with the provider of the RA and the Project-Based Rental Subsidy Agreement.

## **B. Formalizing the Project-Based Rental Subsidy**

Rental subsidy for new and existing projects is formalized through two main documents: the memorandum of understanding, which is between the Agency and the provider of the rental subsidy, and the Project-Based Rental Subsidy Agreement, which is the instrument agreement involving the tenant, borrower, and provider of assistance.

### ***1. Memorandum of Understanding***

The Agency must enter into a memorandum of understanding with the provider of the rental subsidy to make sure that the Government's interests are secure. This memorandum of understanding must include the following provisions:

- The reason for providing the project-based rental subsidy and its intended purpose;
- The length of time the project-based rental subsidy will be provided;
- Actions to be taken at the end of the project-based rental subsidy agreement to minimize the effect on tenants losing the rental subsidy and to avoid displacement; and
- A copy of the proposed project-based rental subsidy agreement.

### ***2. The Project-Based Rental Subsidy Agreement***

The Project-Based Rental Subsidy Agreement is the instrument of agreement involving the tenant, borrower, and provider of assistance.

The Agency will not be a party to the Project-Based Rental Subsidy Agreement nor have any responsibilities under the agreement. However, the Loan Servicer must ensure that the Project-Based Rental Subsidy Agreement provides that:

- The rental subsidy payments will be paid directly to the tenants or deposited to a separate project operating account established for this purpose. The tenants must be advised of the amount and source of the subsidy through the lease or supplement to the lease.
- The life of the Project-Based Rental Subsidy Agreement must be similar to existing or current Agency RA funding levels, and sufficient funds must be set aside in a way that ensures availability of project-based rental subsidy for this term. The method of supplying the funds must be clearly set forth and acceptable to the Agency.
- During the term of the Project-Based Rental Subsidy Agreement, the provider must make available the subsidy amounts required at least annually.

**C. Low-Income Housing Tax Credit Projects**

For projects with low-income housing tax credits (LIHTCs), if the project-based rental subsidy term is less than the LIHTC compliance period, the borrower must demonstrate the marketability of the project-based rental subsidy units by either:

- Demonstrating that there are sufficient households within the LIHTC income limits to support the units without rent overburden; or
- Certifying that the targeted percentage of LIHTC units (not the minimum set-aside option) does not include the project-based rental subsidy units, so that the units will be marketable to households in all Agency program eligible income ranges.

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## **SECTION 4: LABOR HOUSING REQUIREMENTS FOR RENTAL ASSISTANCE**

### **8.14 USING RENTAL ASSISTANCE AS OPERATING ASSISTANCE [7 CFR 3560.574]**

The Agency's rental assistance program, which provides assistance based on each household's income, can be difficult to administer in housing for migrant workers because of frequent tenant turnover and short periods of occupancy.

Borrowers of section 514 or 516 funds for Off-Farm Labor Housing projects may use Agency rental assistance funds for operating assistance rather than for providing rental assistance to individual households. By using operating assistance to reduce operating costs, rental rates can remain lower so that they are affordable to tenants based on the average wages of migrant farmworkers in the area. Tenants in Off-Farm Labor Housing projects that are receiving operating subsidy are still required to provide income verification and household income must be within the very-low or low-income limits to qualify for reduced operating assistance rents. Borrowers must provide documentation of tenant incomes to the Agency.

### **8.15 PROJECT ELIGIBILITY FOR OPERATING ASSISTANCE**

Only Off-Farm Labor Housing project units that are designated for migrant farmworkers are eligible to receive operating subsidy. The property must be eligible to receive rental assistance.

### **8.16 OPERATING SUBSIDY LIMITS**

The amount of operating assistance requested by the owner must be based on the project's actual income and expenses and must be approved by the Agency. In the case of a mixed project, the amount of operating assistance must be based on the portion of actual income and expenses that are attributable to the units that are for migrant farmworkers. In no instance may the annual amount of operating assistance exceed 90 percent of the annual operating costs that are attributable to the migrant units.

### **8.17 OWNER RESPONSIBILITIES.**

#### **A. Requesting for operating assistance program**

Owners of Off-Farm Labor Housing projects with units for migrant farmworkers may request operating assistance by submitting a request to the Agency, which must include a budget. The budget must include:

- Estimated operating costs for the migrant units, including authorized expenditures such as reserve deposits;
- Proposed rental rates for the migrant units to generate sufficient funds for operating costs of those units, taking into consideration all other sources of project income; and

- Estimated rental income from tenants, based on a tenant contribution of 30 percent of the average adjusted monthly income of migrant farmworker households in the area.

**B. Requesting operating assistance payments**

Each month, the owner will submit a request for operating assistance to the Agency.

**C. Verifying tenant income eligibility**

Owners are responsible for verifying tenant income eligibility. Only very low or low-income households are eligible for the operating assistance rents. Households with incomes above the low-income limits must pay the full rent.

**D. Reporting requirements**

Owners will complete and submit to the Agency tenant certifications to document tenant income and eligibility.

Owners will complete and submit monthly to the Agency a project worksheet for operating assistance.

Owners must submit an annual planning budget to the Agency prior to the project's fiscal year.

<b>CHAPTER 9: MONITORING BORROWER COMPLIANCE [7 CFR part 3560, subpart H]</b>
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## 9.1 INTRODUCTION

When borrowers accept Agency loan and grant funds, they agree to operate the property in accordance with program objectives and comply with program requirements established by the Agency. To ensure that borrowers meet these responsibilities, the Agency monitors borrower performance and takes action as needed to see that borrowers fulfill their responsibilities. The previous chapters have described the program requirements for multi-family housing projects and the Agency's procedures for implementing these requirements. This chapter describes the Agency's procedures for monitoring multi-family housing projects to ensure that these requirements are met.

Section 1 of this chapter provides an overview of Agency monitoring activities. Section 2 describes the procedures for performing monitoring activities that are done in the office using borrower submissions. Section 3 presents the procedures for performing monitoring activities conducted at the project. Section 4 describes the project classification system. Section 5 discusses monitoring farm labor housing projects for compliance with program requirements. Section 6 provides an overview of State Office oversight of servicing activities.

## 9.2 AGENCY MONITORING OBJECTIVES AND PRIORITIES

### A. Monitoring Objectives

The Agency will monitor project operations to:

- Ensure the project is managed in accordance with the goals and objectives of the Multi-Family Housing program;
- Preserve the value of the property;
- Ensure that the property is maintained in accordance with Agency requirements for providing housing that is decent, safe, sanitary, and affordable;
- Ensure that the project is operated at actual, necessary, and reasonable costs;
- Detect waste, fraud, and abuse;
- Verify compliance with occupancy requirements; and
- Ensure compliance with affirmative fair housing marketing requirements; Title VI of the Civil Rights Act of 1964; Title VIII of the Civil Rights Act of 1968, as amended; Section 504 of the Rehabilitation Act of 1973; the Age Discrimination Act of 1975; the Americans with Disabilities Act of 1990; other applicable Federal laws; and Agency requirements related to occupancy and tenant eligibility.

## B. Monitoring Priorities

The Agency will monitor the performance of all borrowers. However, to make the best use of its available resources, the Agency will give priority in its monitoring efforts to borrowers with projects that have the greatest risk of poor performance or compliance violations. By focusing more attention on projects experiencing problems, the Agency can maximize the effect of its monitoring activities. Agency monitoring efforts involve three levels of activities:

- **Routine monitoring.** For projects with limited risk of performance or compliance problems, Loan Servicers will conduct routine monitoring. This level of monitoring involves regular checks of project compliance through reviews of regular borrower submissions and periodic onsite visits.
- **Intensive monitoring.** For projects with a higher risk of performance or compliance problems, Loan Servicers will conduct intensive monitoring. This level of monitoring involves not only regular checks of project compliance, but also more frequent borrower reporting and onsite visits by Agency staff.
- **Quality control.** While Loan Servicers conduct routine and intensive monitoring, State Offices are responsible for oversight of Field Office monitoring efforts. The National Office will establish a set of goals for Field Office performance and must use Multi-Family Housing Information System (MFIS), Automated Multi-Family Housing Accounting System (AMAS), and other monitoring reports to ensure that Field Offices are meeting these goals. Additional State Office oversight of Field Office performance is conducted through the State Internal Review (SIR) process.

The procedures for determining the level of monitoring that is appropriate for projects are described in Paragraph 9.15.

## 9.3 BORROWER RESPONSIBILITIES

Borrowers are responsible for cooperating fully with the Agency staff performing monitoring activities. The Agency will notify borrowers in writing of any deficiencies or compliance violations identified during its review. Borrower must address these deficiencies within the correction period established by the Agency and described in the notice.



## SECTION 1: OVERVIEW OF AGENCY MONITORING

### 9.4 AGENCY MONITORING REVIEWS

#### A. Key Parties in the Monitoring Process

Monitoring involves a range of staff from the Agency and throughout the department. Borrowers, their management agents, and tenants also need to be active participants in the monitoring process. Exhibit 9-1 lists the key parties in the monitoring process.

Exhibit 9-1 Key Participants in the Monitoring Process	
Agency and USDA Staff	Other Parties
<ul style="list-style-type: none"> <li>• Loan Servicer</li> <li>• Architectural/Engineering staff</li> <li>• Environmental staff</li> <li>• Civil Rights staff</li> <li>• Office of General Counsel (OGC)</li> </ul>	<ul style="list-style-type: none"> <li>• Borrower</li> <li>• Management agent               <ul style="list-style-type: none"> <li>◊ Manager (Onsite or Offsite)</li> <li>◊ Supervisor</li> <li>◊ Project staff (e.g., leasing, maintenance)</li> </ul> </li> <li>• Tenants</li> </ul>

#### 1. Agency and Other USDA Staff

Effective monitoring of borrower performance requires a coordinated effort on the part of Agency staff from several areas. While Loan Servicers hold primary responsibility for monitoring borrowers and their projects, staff from other offices will often assist in performing monitoring reviews. For example, the State Architect/Engineer may assist in performing physical inspections when Loan Servicers have specific concerns about a project. When performing reviews of the central office of a management agent with properties in several states, Loan Servicers will need to coordinate with their counterparts from the respective states. Finally, if monitoring activities identify significant deficiencies, Loan Officers will often need to obtain the advice of staff from OGC.

#### 2. Borrowers, Management Staff, and Tenants

While the Agency holds responsibility for performing monitoring activities, effective monitoring also requires the cooperation of borrowers and their agents. Their involvement during monitoring reviews is needed to provide access to records and to answer questions about project operations and procedures. Further, when deficiencies are discovered, borrowers, as well as the management agent, need to be informed so that prompt action can be taken to correct the problem. Borrowers notified of deficiencies are responsible for ensuring that the problems are corrected and for keeping the Agency informed about actions taken to address the problems.

Tenants are also important participants in the monitoring process because they can provide valuable information about project operations.

## B. Monitoring Methods and Activities

The Agency uses two basic types of monitoring methods:

- **Desk reviews.** These reviews involve examining project reports submitted by the borrower. Generally, Loan Servicers perform these reviews.
- **Onsite reviews.** These reviews are conducted at the project and involve the inspection of both project conditions and records. Loan Servicers will often draw on the technical expertise of other staff to assist in performing these reviews.

The specific reviews that fall into each category are summarized in Exhibit 9-2. Each of these reviews is described in greater detail in subsequent sections of this chapter.

Exhibit 9-2 Agency Monitoring Reviews	
Desk Reviews	Onsite Reviews
Quarterly/Monthly reports	Post-occupancy review
<b>Annual project financial report</b>	<b>Annual physical reviews</b>
Occupancy trends/vacancy turnover	Physical inspection
Unused rental assistance	Occupancy review
Agency internal quality control	Management review
Tenant subsidy review	Compliance review
Note: <b>Routine reviews</b> are listed in bold.	

## C. Key Documents and Sources of Information

The Agency relies on a range of sources to inform its monitoring activities. These sources are summarized in Exhibit 9-3.

Exhibit 9-3		
Key Sources of Information for Agency Monitoring		
Agency Records	Project Records	Other Sources
<b><u>Project Case File</u></b>		
Loan agreement/resolution	Project worksheets	Onsite visits by Agency staff
Interest credit agreement	Project budgets	Reports from other Agency staff
Rental assistance agreement	Annual financial report	Tenant reports/complaints
Affirmative Fair Housing	Financial records	Reports/Information from local officials
Marketing Plan	Tenant files (eligibility documentation)	Reports/Information from community members
Lease	Marketing records and applications	Compliance monitoring and inspection reports received from other financing or subsidy sources involved with the property
Management certification	Waiting lists	
Management plan	Maintenance records	
<i>Form RD 3560-52, Promissory Note</i>	Occupancy policies	
Annual financial statements	Occupancy rules	
Borrower organizational documents		
<b><u>Automated Systems</u></b>		
AMAS		
MFIS		

### ***1. Agency Records***

The project case file and other Agency records provide information about the specific responsibilities of the borrower and also the operation of the project. As discussed in previous chapters, program requirements vary depending on the type of project and the type of financing the borrower received. The case file documents indicate the type of project and the specific terms of the Agency's financing. For example, these documents specify the replacement reserve requirements and the owner's annual return. The case file also contains the management certification and management plan, which provide key information about project operations.

Agency records include the automated systems used to administer the program. AMAS and MFIS contain information that aids in monitoring projects.

Official records contain legal evidence of all transactions between the Agency and the persons with whom it conducts business. For information about the required contents and organization of the borrower case file, see RD Instruction 2033-A.

### ***2. Project Records***

Project records are documents that provide information about the ongoing operation of the project. Project worksheets, budgets, and tenant certifications are examples. Loan Servicers examine these records during monitoring reviews to evaluate project performance and compliance.

### **3. *Other Sources***

In addition to site visits conducted by Loan Servicers or other staff to observe project operations, the Agency also draws on other sources to inform monitoring activities. Substantiated reports by tenants or community members noting inadequate conditions or improper practices are examples. Reports of performance problems in other states involving the same borrower or agent are also a source of concern. This type of information does not necessarily confirm that a problem is present, but indicates a need for further review of a project's operations.

## **9.5 PLANNING MONITORING ACTIVITIES**

Planning monitoring activities involves scheduling routine reviews and determining the extent to which in-depth monitoring needs to be conducted. Loan Servicers and their Multi-Family Housing Program Directors should review annually their plan to monitor their portfolio. Exhibit 9-2 indicates the reviews that are performed routinely and those classified as in-depth reviews.

### **A. Routine Monitoring**

Each year, Loan Servicers must schedule routine monitoring reviews and designate the staff that will perform these functions. These activities—together with the regular program administration activities performed by Loan Servicers—ensure that all projects receive a basic level of oversight each year to check for evidence of deficiencies or potential problems.

In scheduling these activities, Loan Servicers need to ensure that the appropriate staff are available to perform these reviews. Annual physical reviews should be planned to coincide wherever possible with other activities that take staff to the vicinity of the projects.

### **B. In-Depth Monitoring**

When planning monitoring activities for the year, Loan Servicers must determine which projects warrant in-depth reviews and the types of reviews needed. In-depth reviews are done periodically to check for continued project compliance. These reviews are also performed more frequently for projects experiencing distress or when there is clear evidence of compliance concerns.

Loan Servicers may schedule these reviews to take place at any time during the year. They may also need to be scheduled on short notice during the year in response to evidence of problems. When scheduling these reviews, Loan Servicers will need to coordinate with the other staff participating in the review (e.g., architectural staff).

## 9.6 PERFORMING MONITORING REVIEWS

### A. Desk Reviews

Desk reviews are usually performed solely by the Loan Servicer and require little coordination with other staff. Performing these reviews generally involves three basic steps:

- **Preparing and reviewing background material.** Loan Servicers should gather the project case file and assemble past reports and other relevant records. In addition to reviewing these documents, Loan Servicers should also review the relevant screens in AMAS or MFIS to gain an up-to-date understanding of the project's status and potential concerns.
- **Examining the borrower's monthly and quarterly reports.** Loan Servicers then review the borrower's monthly or quarterly reports following the specific instructions in Section 2 of this chapter or using the instructions that accompany the Agency's review form. Loan Servicers must make every effort to complete the review within the established time period. If additional information is needed to complete the review, Loan Servicers should promptly contact the borrower to request additional information.
- **Notifying borrower of any findings.** If the review reveals deficiencies or compliance violations, the borrower must be promptly notified. The notice must describe the deficiencies and a period for corrective action. If a third party is involved in financing or providing subsidy to the property and a formal arrangement exists with this third party, the Agency will provide a copy of the notice to the third party source to share information concerning the Agency's findings.

### B. Onsite Reviews

Onsite reviews take more preparation and planning than desk reviews. The Agency expects Loan Servicers to follow the four steps below when performing onsite reviews. The actions at each step will vary depending on the type of review. The specific actions for individual reviews are discussed in Section 3 of this chapter.

#### *1. Preparing for the Visit*

Loan Servicers should notify the borrower and agent prior to a visit, unless the review is planned as an unannounced visit. The Agency retains the authority to visit the project, without prior notice, to observe conditions and operations and to conduct onsite reviews without the presence of the borrower or the borrower's agent.

Borrowers should generally be given 2 weeks' notice. The notice should specify the types of preparations (if any) that the borrower must complete to assist with the review. The Loan Servicer should also coordinate with other staff who will participate in the review to clarify assignments and responsibilities.

The Loan Servicer should also review the relevant Agency records and project reports to learn the project's current status and identify potential issues that should receive special attention during the review. Finally, the Loan Servicer should fill in the background information items on the monitoring instrument.

## ***2. Conducting the Visit***

When conducting an onsite visit, Loan Servicers and other Field Office Staff should conduct an entrance interview with the manager or borrower (if available). During this meeting, the reviewers should explain the purpose of the review, describe the major activities, and indicate the type of cooperation that will be needed from project staff.

When conducting the review, monitors should follow the procedures described in Section 3 of this chapter and the instructions that accompany the monitoring tool. Reviewers must carefully record their observations to ensure that problems are not missed or incorrectly identified.

Upon completing the review, the monitors should briefly consolidate their results and meet with the manager or borrower to present the initial findings from the review. The Loan Servicer should highlight any findings and/or violations at this meeting.

## ***3. Notifying the Borrower***

The monitors must prepare a written description of the review results for the project case file. They must also issue a letter to the borrower summarizing the conclusions of the review and indicate any follow-up actions the borrower is required to take. In addition, the results of the review should be forwarded to other offices working with this borrower or agent.

This letter is sent to the borrower within 30 days of the review completion. This letter requests the borrower to respond with procedures and time frames for correcting the noted deficiencies within 30 days. The purpose of letter is to:

- Notify the borrower of review findings; and
- Provide time frames for resolving deficiencies.

As is the case with desk reviews, if a third party is involved in financing or providing subsidy to the property and a formal arrangement exists with this third party, the Agency will provide a copy of the notice to the third party source to share information concerning the Agency's findings.

#### ***4. Follow-Up Activities***

If a review identifies deficiencies that require borrower action, the Agency needs to conduct follow-up actions as appropriate to ensure that the deficiencies are corrected. For information about findings and default situations, see HB-3-3560, Chapter 10.

A copy of the letter is placed in the borrower's case file and must be entered on MFIS.

#### **C. Central Office Reviews**

Loan Servicers should follow the procedures presented in Chapter 3 when performing central office reviews of management entities.

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## **SECTION 2: DESK REVIEWS**

### **9.7 QUARTERLY/MONTHLY REPORTS**

Borrowers with new projects are required to submit quarterly reports. However, Loan Servicers may require these borrowers or any other borrower to submit monthly reports if the following factors exist:

- Weak financial condition;
- Sudden increases in vacancies;
- Sudden increases in accounts receivable or accounts payable;
- Violations of policy or reporting practices;
- Audit findings; or
- Failure to submit the quarterly report for two quarters.

#### **A. Purpose**

Reviewing borrower's quarterly/monthly reports enables the Agency to:

- Monitor the project's financial performance on a frequent basis;
- Look for indicators of operational or financial problems such as increased vacancies; and
- Address issues or areas of concern before they become major issues.

#### **B. Key Areas Examined**

The Loan Servicer looks at the project's income, expenses, and vacancy rates.

#### **C. Timing**

The Loan Servicer completes the review within 10 days of receiving the report.

#### **D. Key Staff**

Loan Servicers perform this review.

#### **E. Preparing for the Review**

The Loan Servicer will compile the following documentation in preparation for a review of a new quarterly/monthly report:

- Current quarterly/monthly report;
- Quarterly/monthly reports year-to-date; and
- Current project budget.

#### **F. Completing the Review**

The Loan Servicer will complete the following steps to perform the review:

- **Step 1.** Compare the current and year-to-date quarterly/monthly reports. The Loan Servicer considers the changes in vacancy rates, accounts receivable, and accounts payable.
- **Step 2.** Compare the current report to the project budget to determine the year-to-date status of project operations
- **Step 3.** Complete the review and forward the borrower's report with any findings to the State Office by the thirtieth day following receipt of the report.

#### **G. Follow-Up**

If reports reveal that project expenditures are exceeding income or vacancies and accounts receivable or accounts payable are increasing, the Loan Servicer will initiate verbal and written dialogue with the borrower for further resolution of problems. Other follow-up actions may include:

- Requesting monthly reports if quarterly reports are currently being received; and
- Performing an onsite review of financial records.

If borrowers fail to submit the report by the thirtieth day after the reporting period, the Loan Servicer will:

- Notify borrowers, in writing, of their responsibility to submit the required reports and request them to send the delinquent report; and
- Notify the State Office of the borrower's failure to submit the report to determine the Agency's next servicing action.

### **9.8 OVERSEEING THE USE OF AGENCY RA**

The Loan Servicer oversees how RA is being distributed and administered through Agency computer systems and supervisory visits.

## A. Automated Systems

There are two main computer systems used in processing payments and subsidies.

### 1. Multi-Family Housing Information System

MFIS, among other things, is a Field Office database used to process tenant subsidies, such as RA and interest credit (Exhibit 9-4). This is the automated system that tabulates and maintains the data that is used to prepare *Form RD 3560-29, Notice of Payment Due Report* which the borrower keys into the system. Reports can be generated for each project, based on information entered, so that the Field Office can analyze data before making administrative decisions.

**Exhibit 9-4**  
**Multiple Uses of MFIS**

- Check and approve mathematical calculations on *Form RD 3560-8, Tenant Certification*;
- Perform calculations for Interest Credit and RA worksheets;
- Record and analyze the tenant occupancy status;
- Analyze rent overburden or vacancy problems; and
- Review project status to uncover potential servicing problems.

### 2. Automated Multi-Family Housing Accounting System

AMAS is a computerized accounting system that sets up each loan account in the St. Louis Office. It was implemented to automate loan account processing and payment processing in the Field Offices and to provide an on-line link between the Field Office, the State Office, the National Office, and the St. Louis Office. AMAS is used to track RA obligations and usage. Each State Office has a designated AMAS Coordinator who can assist the Loan Servicer in making the best use of the system.

## B. Supervisory Visits

Prior to a supervisory visit, the Loan Servicer should review MFIS records to look at trends and RA use. For example, during supervisory visits, the Loan Servicer should contact tenants identified by the borrower on *Form RD 3560-29*, as receiving an RA check and ask them what they are actually paying in rent. This information can be compared to what the borrower is reporting and any discrepancies investigated.

## 9.9 REVIEW OF PROJECT ANNUAL FINANCIAL REPORT

The Agency Engagement Guide describes the requirements of project annual financial reports, as stated in Chapter 4, paragraph 4.30. The following describes what the Loan Servicer

must do when reviewing actual operating income and expense data from the annual financial report.

### **A. Entering Income and Expense Actuals on MFIS**

The Loan Servicer will enter the actuals on MFIS and use the analysis information provided by the system in reviewing the borrower's compliance with program regulations, while reviewing actual operating income and expense figures submitted by a borrower on *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* with year-end financial information, unless already entered by the borrower through Management Interactive Network Connection (MINC).

### **B. Analytical Capabilities of MFIS**

MFIS uses a powerful process to prepare information for the Agency's review and analysis of project budgets with actual figures. The results of this process are available online or through a system-generated report. Loan Servicers must use the MFIS analysis information to review actual budgets.

The MFIS analysis process should be the primary mechanism for budget review; however, additional information may be considered when the Loan Servicer deems that it is relevant to protect the financial integrity of the project. Budget compliance decisions, which may result in findings or violations, are based on MFIS analysis information and any additional relevant issues.

### **C. Procedures for Reviewing Actuals Against Project Budgets**

Unless already entered by the borrower through MINC, the Loan Servicer must enter the actual budget submitted on *Form RD 3560-7* into MFIS. The MFIS analysis information provides the Loan Servicer with the difference between the actual budget and the proposed budget, as well as the difference between the actual budget and system-generated norms that match the profile of the project being studied. The Loan Servicer will use these results as a primary source of information for review of the borrower's actual budget.

### **D. Procedures for Reviewing Disposition of Interest Earned on Reserve Accounts**

With Agency approval, borrowers operating on a for-profit or a limited-profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year. However, the Loan Servicer must ensure that the borrower does not take this amount if the property has pressing needs. The annual financial statements provide the reserve account balance at the end of the year, as well as outstanding accounts payable. MFIS enables the Loan Servicer to determine if the project has pressing physical needs. If the project has health and safety violations that it cannot afford to address or if there are substantial deferred maintenance items that have not been addressed, the Loan Servicer will not allow the borrower to take the interest on the reserve account.

## SECTION 3: ONSITE REVIEWS

### 9.10 POST-OCCUPANCY REVIEW

#### A. Purpose of the Review

The post-occupancy review verifies borrower compliance with program requirements for project occupancy during initial lease-up and looks at whether the procedures described in the Management Plan and Affirmative Fair Housing Marketing Plan are being followed. Specifically, the review examines how borrowers:

- Seek eligible tenants;
- Determine tenant eligibility; and
- Determine the appropriate rent.

#### B. Key Areas Examined

The monitor examines the borrower's rent-up activities as detailed below.

- **Project records.** These include the actions that the borrower takes to attract qualified tenants, determine tenant eligibility, and determine correct rental rate. The project's management plan and Affirmative Fair Housing Market Plan contain the borrower's procedures for tenant selection and for determining the rental rate.
- **Tenant files.** The borrower must maintain files for each tenant. Tenant files must include such information as income verification, the lease, and documentation showing how tenant eligibility was established and how the rental rate was determined.

To complete the review, the staff person will also need the project's waiting lists (if applicable) and budget. These documents will be used to determine if the borrower is in compliance with the occupancy requirements set forth in Chapter 6 and the approved unit rental rates established in the project budget.

#### C. Timing

The post-occupancy review is conducted within 90 days after project operations begin.

#### D. Key Staff

The post-occupancy review is performed by Loan Servicers.

### E. Preparing for the Review

The monitor should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance exist by reviewing the borrower case file and MFIS.
- **Step 2.** Notify borrower, in writing, of upcoming review. The borrower should receive *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* 30 days prior to the review date to ensure that the necessary records and staff are available.
- **Step 3.** Obtain the Multi-Family Housing Project Management and Occupancy Review form from MFIS.

### F. Completing the Review

The monitor should use the worksheets for the Multi-Family Housing Occupancy Review and MFH Individual Tenant File Review for guidance. The borrower will have available the documentation requested by the staff member. The borrower may choose to be present during the review. The borrower's choice not to be present does not preclude the staff person from performing the review.

To complete the Post-Occupancy Review, the monitor must complete the following steps:

- Briefly review the Management Plan and Fair Housing Marketing Plan. This documentation is evidence that the borrower was aware of the procedures that were to be followed during initial rent-up.
- Review tenant files, waiting lists (if applicable), and budget. The tenant files should include a sample of accepted and rejected applicants. The reviewer must determine the following:
  - ◊ If requested documentation is present and adequate to perform the review;
  - ◊ Borrower's compliance with established procedures for marketing the project, qualifying tenants, determining rents, using waiting lists, and rejecting applicants.
- Complete the Occupancy Review Summary section on the first page of the Multi-Family Housing Project Management and Occupancy Review worksheet.
- Conduct an exit interview with the borrower to discuss the results of the review, possible cause of deficiencies, and required solutions.
- Enter the results of the post-occupancy review in MFIS.

## **G. Follow-Up**

Loan Servicers will follow up with the borrower as appropriate.

## **9.11 ANNUAL PHYSICAL WALK-ABOUT INSPECTION**

### **A. Purpose**

Maintaining the physical condition of the secured property is the borrower's responsibility. The Agency monitors the physical condition of the project to ensure that the property maintains its value and that tenants have housing that is decent, safe, and sanitary.

### **B. Key Areas Examined**

The monitor will inspect the project's grounds, exteriors, and common areas. A physical inspection must be performed when the results of this review indicate that the project is not being maintained in accordance with the physical standards for the program.

### **C. Timing**

The annual walk-about must be completed at least 90 days prior to the end of the borrower's fiscal year. This timing enables the results of the inspection to be used by the Loan Servicer during review of the borrower's proposed budget. When a complete physical inspection is not performed, the Loan Servicer completes a walk-about inspection using the worksheet for MFH Exterior Physical Standards and summary section of the Multi-Family Housing Physical Inspection Report contained in the Multi-Family Housing Project Management and Occupancy Review worksheet. If the Loan Servicer completes a physical inspection and has no findings regarding the physical status of a project, the following annual walk-about may be omitted. However, each project must receive either a walk-about inspection or full physical inspection at least once every two years.

### **D. Key Staff**

The physical review is performed by Field Office Staff. The review can be performed by staff with little or no inspection experience. However, inexperienced staff should be accompanied by an experienced Loan Servicer during their first two visits to the property.

### **E. Preparing for the Review**

The monitor should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance with Agency requirements exist by reviewing the borrower case file,

previous physical reviews, most recent inspection report, tenant complaints (if applicable), and MFIS.

- **Step 2.** Notify borrower, in writing, of upcoming review. The borrower must receive *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* 30 days prior to the review date to ensure that the necessary records and staff are available.
- **Step 3.** Obtain the Multi-Family Housing Project Management and Occupancy Review worksheet from MFIS.

## **F. Completing the Review**

The Loan Servicer should use the worksheet for MFH Exterior Physical Standards for guidance. To complete the review, the monitor will complete the following steps:

- Examine the project's grounds, exteriors, common areas.
- Photograph any deficiencies noted during the examination.
- Complete the Exterior Maintenance Summary section of the Multi-Family Housing Physical Inspection Report worksheet.
- Conduct an exit conference with the borrower. The exit conference allows the borrower to ask questions and to prepare an appropriate response to the findings report. In this meeting the reviewer and the borrower can discuss the requirements and time frames for resolving each finding.
- Enter the results of the walk-about inspection into MFIS.

## **G. Follow-Up**

If the noted findings involve issues of health and safety, *Handbook Letter 301 (3560)*, *Servicing Letter #1* is sent within 15 days after review. The letter requires that health and safety issues be resolved within 10 days. *Handbook Letter 301 (3560)*, *Servicing Letter #1* and the servicing letter process is outlined in Chapter 10 of HB-3-3560.

# **9.12 FULL PHYSICAL INSPECTION**

## **A. Purpose**

Adequate maintenance is a crucial element in providing housing that is decent, safe, and sanitary and ensuring that environmental and civil rights requirements are met. The Agency regularly conducts full physical inspections of its properties to ensure that they meet established program standards.



## **B. Key Areas Examined**

The monitor will inspect the project's grounds, exteriors, common areas, and a sample of dwelling units. The Agency will select a minimum of two units in a project or 20 percent of the units in the project.

## **C. Timing**

Physical inspections must be conducted at least once every three years. Field Office Staff should conduct inspections more frequently for projects with management that is unfamiliar with Agency requirements and for projects with poor maintenance performance.

## **D. Key Staff**

Physical inspections are performed by field staff. These inspections can be performed by staff members with little or no inspection experience. However, inexperienced staff should be accompanied by an experienced Loan Servicer during their first two visits to the property.

## **E. Preparing for the Review**

The monitor should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance with Agency requirements exist by reviewing the borrower case file, previous physical reviews, most recent inspection report, tenant complaints (if applicable), and MFIS;
- **Step 2.** Review borrower's management plan, closely review the maintenance program;
- **Step 3.** Review borrower's budgeted maintenance expenses and assess whether they appear to be in the average range;
- **Step 4.** Review work-out plan, if applicable;
- **Step 5.** Notify borrower, in writing, of upcoming review. *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* should be received by the borrower 30 days prior to the review date to ensure that the necessary records and staff are available; and
- **Step 6.** Obtain *Form RD 3560-11, MFH Physical Inspection Report* from MFIS.

## F. Completing the Review

The Loan Servicer should use and complete the worksheet for MFH Exterior Physical Standards and the worksheet for MFH Interior Physical Standards and Tenant Interviews. To complete the review, the monitor will complete the following steps:

- Examine the project's grounds, exteriors, common areas, and a minimum of two units or 20 percent of the units.
- Complete all parts of the *Form RD 3560-11*, including:
  - ◊ Section 1—that records pertinent project information, as well as summary findings from the exterior and interior physical standards worksheets;
  - ◊ Section 2—that records the results of the compliance review with exterior physical standards; and
  - ◊ Section 3—that records the results of compliance with interior physical standards.
- Review the extent of borrower compliance with the physical accessibility requirements of civil rights laws. Review the ability of the project's current budgeting and capital planning to implement any improvements identified by the borrower's transition plan. For information on transition plans, see Chapter 3.
- Photograph any deficiencies noted during the examination.
- Conduct an exit conference with the borrower. The exit conference allows the borrower to ask questions and to prepare an appropriate response to the findings report. In this meeting, the monitor and the borrower can discuss the requirements and time frames for resolving each finding.
- Enter the results of the inspection into MFIS.

## G. Findings and Violations

*Form RD 3560-11* requires the reviewer to make the determination of what previously would be noted as a deficiency or a weakness, but now is reported as a "finding" or "violation."

A "finding" is a failure to meet physical standards that should be corrected through routine procedures. A "violation" is a finding that is elevated either by its severity or the Agency's inability to obtain a resolution from routine servicing methods.

If a "finding" or "violation" is identified in any subitem of one of *Form RD 3560-11*'s 14 categories, the Loan Servicer will determine if the overall rating of that category should be coded a "finding" or "violation." A category-level violation should be recorded only if the Loan Servicer intends to pursue the problem through the three servicing letter process. Elevating a finding to a violation will have an effect on the

classification of a project. For information on project classification, see Section 4 of this chapter.

If the results of a physical inspection indicate a finding or violation for “Common Area Accessibility,” “Fully Accessible Units,” or other relevant standards during a supervisory visit, the Loan Servicer should include the specific language in communications with the borrower as shown below in Exhibit 9-5.

**Exhibit 9-5**  
**Sample Language – Civil Rights Violations**  
**Detected During Physical Inspections**

“Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued noncompliance may result in your ineligibility to receive further loan funds from the Agency. You failed to meet the following MFH physical standard(s):

1. Common Area Accessibility (Specify)
2. Fully Accessible Units (Specify)
3. Other (Specify).”

## **H. Follow-Up**

If the noted findings involve issues of health and safety, *Handbook Letter 301 (3560)*, *Servicing Letter #1*, as described in Chapter 10 of HB-3-3560, is sent within 15 days after review. The letter requires that health and safety issues be resolved within 10 days.

## **9.13 OCCUPANCY REVIEW**

### **A. Purpose of the Review**

The purpose of the occupancy review is to determine the borrower’s continued compliance with the occupancy requirements for the project. This review also includes an examination of unit rents to ensure that they are being charged in accordance with the approved budget.

### **B. Key Areas Examined**

The monitor reviews the borrower’s occupancy procedures and rent charge calculations.

### C. Timing

Occupancy reviews must be conducted at least once every three years. Reviews should be conducted more frequently for projects experiencing occupancy difficulties.

### D. Key Staff

The occupancy review is performed by the Loan Servicer.

### E. Preparing for the Review

The monitor should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance exist by reviewing the borrower case file and MFIS screens;
- **Step 2.** Notify borrower, in writing, of upcoming review. *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* should be received by the borrower 30 days prior to the review date to ensure that the necessary records and staff are available; and
- **Step 3.** Obtain Multi-Family Housing Project Management and Occupancy Review worksheet from MFIS.

### F. Completing the Review

The Loan Servicer should use the worksheet for MFH Occupancy Review and the Multi-Family Housing Project Management and Occupancy Review worksheet for guidance. To perform the occupancy review, the monitor must complete the following steps:

- **Review project records** including marketing materials, applications, and waiting lists. The monitor should determine whether the marketing materials indicate that the project is complying with the Fair Housing Marketing Plan. The monitor should also determine whether the applications and waiting list records indicate that the borrower is complying with tenant selection requirements.
- **Review tenant files**, which should include such information as income verifications, back-up documentation, the leases, and documentation showing how the rental rates were determined. The sample files should include accepted and rejected applicants. The reviewer must determine whether:
  - ◇ The borrower is maintaining adequate documentation; and
  - ◇ The borrower is complying with program requirements for marketing the project, qualifying tenants, determining rents, using waiting lists, and rejecting applicants.

- Complete the Occupancy Summary section of the Multi-Family Housing Project Management and Occupancy Review worksheet.
- Conduct an exit interview with the borrower to discuss the results of the review, possible cause of deficiencies, and required solutions.

## **9.14 MANAGEMENT REVIEW**

### **A. Purpose of the Review**

The Management Review is a detailed analysis of the project's physical and fiscal operations. This review enables the Agency to determine the project's financial and operational viability.

### **B. Key Areas Examined**

This review examines the project's financial systems and controls along with its maintenance and preventive maintenance programs.

### **C. Timing**

Management reviews are conducted at least every three years. Reviews should be conducted more frequently for projects experiencing operational difficulties or for projects that are at risk for compliance problems.

### **D. Key Staff**

These reviews are performed by Loan Servicers.

### **E. Preparing for the Review**

The monitor will complete the following steps prior to performing the onsite review:

- **Step 1.** Examine the following information:
  - ◇ Borrower's case file and MFIS for outstanding issues or areas of concern;
  - ◇ Quarterly/monthly reports;
  - ◇ Management Plan;
  - ◇ Annual budget;
  - ◇ *Form RD 3560-8*; and
  - ◇ Monthly project worksheets.

- **Step 2.** Notify borrower, in writing, of upcoming review. *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* should be received by the borrower 30 days prior to the review date to ensure that the necessary records and staff are available.
- **Step 3.** Obtain the Multi-Family Housing Project Management and Occupancy Review worksheet from MFIS.

#### **F. Completing the Review**

The monitor should use the MFH Project Management Review contained in the Multi-Family Housing Project Management and Occupancy Review worksheet for guidance. At the project site, the examiner will review the following:

- Financial compliance and condition rent collection practices;
- Accounts receivable and accounts payable;
- Reserve accounts;
- Capital planning;
- Cash control; and
- Cost controls.

The monitor must complete page 1 of the Multi-Family Housing Project Management and Occupancy Review.

Upon completing the review, the examiner should conduct an exit conference with the borrower to address findings, cause of findings, and possible resolutions.

#### **G. Follow-Up**

If there are any findings or violations, the Loan Servicer should use the servicing letter process outlined in Chapter 10 of HB-3-3560 to follow up with the borrower.

### **9.15 COMPLIANCE REVIEW**

#### **A. Purpose of the Review**

The purpose of the compliance review is for Agency staff to review the borrower's compliance with the Affirmative Fair Housing Marketing Plan and/or the Equal Opportunity requirements of Title VI of the Civil Rights Act of 1964, the Civil Rights Act of 1968 as amended by the Fair Housing Amendments Act of 1988, Section 504 of the Rehabilitation Act of 1973, and the Age Discrimination Act of 1975.

## **B. Key Areas Examined**

When conducting a compliance review at a project or at the borrower's or management agent's office, the Loan Servicer will focus on the following areas:

- Marketing procedures;
- Rental policies;
- Waiting list;
- Project and unit accessibility;
- Eviction policy; and
- Other operating policies, as relevant.

## **C. Timing**

If initial rent-up or occupancy has not occurred by the time of initial compliance review, a subsequent review will be due one year following initial occupancy and then every 36 months thereafter. Agency staff may schedule more frequent reviews as necessary.

## **D. Key Staff**

An authorized State Office staff member or Loan Servicer from the Field Office will complete the Civil Rights and Fair Housing review requirements. To conduct a compliance review, the Loan Servicer must go through training and obtain a special certification.

## **E. Preparing for the Review**

The monitor will complete the following steps prior to performing the Compliance Review:

- **Step 1.** Review the most recent borrower's case file, the running records, correspondence, and other records to be fully aware of any outstanding civil rights violations at the project. Before completing the compliance review, the Loan Servicer should be aware of:
  - ◇ The borrower's operating regulations (e.g., the grounds for eviction from a Section 515 project);
  - ◇ The borrower's method of advertising the project to the public, whether there is any advertising, and how these methods will reach the minority community; and
  - ◇ Any records of request for use of the project.

This awareness should be developed into an informal visit plan and include, but not be limited to, such things as review of the project's marketing plan, tenant waiting list, review of applicant files, correspondence from tenants, and interviews with tenants.

- **Step 2.** Notify borrower, in writing of upcoming review. *Handbook Letter 202 (3560)*, *Notification Letter for Supervisory Visit* should be received by the borrower 30 days prior to the review date to ensure that the necessary records and staff are available.

## **F. Monitoring Borrower Compliance with the Self-Evaluation and Transition Plan**

During a compliance review, Loan Servicers must review self-evaluations and transition plans made available by borrowers. To ensure that the borrower complies with the self-evaluation and transition plan requirements of civil rights laws, during the compliance review Agency staff will:

- Visually inspect the project to determine if there are physical barriers;
- Review the management plan to determine project management's method of informing tenants and applicants regarding requests for reasonable accommodations. Visit and interview tenants to determine if the borrower has provided information and made reasonable accommodations upon request by the tenant;
- Visit and interview tenants in the fully accessible units to determine:
  - ◊ If the tenant has need of the accessibility features of the unit and is an eligible occupant; and
  - ◊ When the tenant is an ineligible occupant of the unit, if the tenant and borrower have executed a lease attachment that requires the tenant to move if an individual needing the handicapped features applies for occupancy;
- Review the lease agreement, application, and other documentation used by the borrower to determine if policies and procedures represent barriers to occupancy;
- Review the self-evaluation plan and transition plan and compare the physical inspection to determine if there are barriers present that were not addressed or scheduled to be removed;
- Where transition plans are scheduled to remove barriers over more than a one-year period, review the transition plan and the most recently approved budget to ensure that borrower budgeting and the project's financial condition is supportive of the transition plan as written. Transition plans should include the potential cost of removing identified barriers.



## **G. Completing the Review**

The Agency staff member who will conduct the compliance review should spend sufficient time at the project to accomplish the visit plan and any additional needs that are observed or brought out by the tenants, members, or management staff.

## **H. Follow-Up**

The Loan Servicer should record any determination that the borrower is or is not in compliance with Title VI, together with information such as that outlined in subparagraph A of this section, in the running record. The preparation notes and results of each visit should be recorded and filed in the borrower's servicing file. The Loan Servicer must send a letter highlighting any needed follow-up actions and a copy of the completed compliance review report to the management agent and/or the borrower within 30 days after the visit. Follow-up will continue through resolution of any problems. Any major problems with the project will be reported in writing to the State Director with recommendations for corrective action.

The Loan Servicer must follow up with the borrower when the compliance review determines the following:

- The borrower has not completed a self-evaluation when required;
- The borrower's self-evaluation does not adequately address required components;
- The borrower has not completed a transition plan when required by the self-evaluation;
- The borrower's transition plan does not adequately address required components;
- The borrower has failed to comply with the transition plan; and/or
- The borrower is in noncompliance with other Civil Rights law requirements.

If one of the conditions listed above exists, the Loan Servicer must:

- Enter the appropriate finding on MFIS; and
- Give the borrower a 30-day written notice to come into compliance.

If the results of a compliance review indicate noncompliance with Civil Rights laws, the Loan Servicer should include specific language in contacts with the borrower regarding noncompliance, as shown in Exhibit 9-6.

**Exhibit 9-6**

**Sample Language to Use When Compliance  
Reviews Uncover Violations to Civil Rights Laws**

“Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued noncompliance may result in your ineligibility to receive further loan funds from the Agency. You are in noncompliance with the following: (Specify).”

If a borrower fails to either bring themselves into compliance within 30 days or to submit an acceptable transition plan to bring themselves into compliance, the Servicing Office will notify the State Civil Rights Coordinator/Manager (SCRC/M). The State Director will forward the issue of noncompliance to the National Office Civil Rights Staff.

The National Office Civil Rights Staff will notify the State Director if further review and processing of the finding will either resolve the finding or require that it be forwarded to the National Office Civil Rights Staff or the Justice Department to resolve the noncompliance issue.

The SCRC/M will notify the State Office MFH Program Director and the Loan Servicing Office of the disposition of the finding of noncompliance.

## SECTION 4: PROJECT CLASSIFICATION SYSTEM

### 9.16 PROJECT CLASSIFICATION

The project classification system allows the Agency to focus on those projects that Loan Servicers consider truly at risk. The following paragraphs provide a brief description of how the Agency views the classification of the portfolio.

Loans may be reclassified in MFIS as findings and violations are determined or as project conditions improve.

### 9.17 “CLASS D” PROJECTS

Class D projects are in default and may be taken into inventory, be lost to the program, or cause the displacement of tenants. Defaults can be monetary or nonmonetary. For information about monetary and nonmonetary defaults, please refer to HB-3-3560, Chapter 10.

Projects in nonmonetary default are those where a Loan Servicer has notified the borrower of a violation using the Agency’s three processing letter process, as described in Paragraph 9.6 B of this chapter, and the borrower has not addressed the violation to the Loan Servicer’s satisfaction within 60 days of the first servicing letter. The Loan Servicer, State Office, and National Office should be aware that the project is in jeopardy and should be available to provide further servicing assistance.

### 9.18 “CLASS C” PROJECTS

Class C projects are projects with identified findings or violations. They include projects with violations where *Handbook Letter 301 (3560)*, *Servicing Letter #1*, (**Attachment 10-A**), has been issued but 60 days have not passed. It is important to note that while the presence of a finding or violation is a normal occurrence in portfolio management, Loan Servicers will be concerned when findings and violations are carried for an extended period of time with no indication of resolution efforts. Projects under this classification for an extended period of time will alert Loan Servicers to one or more of the following:

- There may be workload or staffing issues related to resolving problems;
- Findings may need to be elevated to violations to facilitate effective servicing; and
- Assistance from the State Office or the National Office may be necessary to address the problem.

### 9.19 “CLASS B” PROJECTS

A Class B designation indicates that the Agency has taken servicing steps and the borrower is cooperating to resolve identified findings or violations with the use of a work-out plan.

### 9.20 “CLASS A” PROJECTS

Class A projects have no unresolved findings or violations.

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## **SECTION 5: AGENCY MONITORING FOR LABOR HOUSING PROJECTS**

### **9.21 OFF-FARM LABOR HOUSING**

Off-Farm Labor Housing projects should be monitored in accordance with the requirements established in this chapter for other multi-family housing projects.

### **9.22 ON-FARM LABOR HOUSING**

On-Farm Labor Housing projects should be reviewed by the Agency at least once every three years. During the monitoring visit, Loan Servicers Staff should review:

#### **A. Eligibility Documentation**

Borrowers should properly document that each resident is eligible to live in the On-Farm Labor Housing unit. At a minimum the borrower should have an executed lease or employment contract with each tenant and each tenant should meet the eligibility requirements established for On-Farm Labor Housing tenants in Section 9 of Chapter 6.

#### **B. Financial Information**

The borrower must document that the on-farm labor housing unit(s) are being operating in a nonprofit manner. At a minimum the borrower should develop an operating budget that demonstrates revenues equal expenses and the borrower is not receiving a return from the property.

#### **C. Operating Plan**

The review of the operating plan should also ensure that the property is being managed in a nonprofit manner and that tenant requests and grievances are being handled in a timely manner and in accordance with the management plan.

#### **D. Loan Agreement**

The review of the loan agreement should ensure that the borrower is in compliance with the agreement made to the Agency to provide adequate housing to the employees in the borrower's employment and not to charge rent, unless otherwise approved by the Agency.

#### **E. Security Deposits**

If the borrower has charged security deposits to the tenants, then the review should ensure that security deposits are being managed in accordance with state and/or local law.

**F. Payment of Taxes and Insurance**

The review of taxes and insurance should ensure that taxes are being paid in a timely manner and at the very minimum to ensure that the borrower has adequate insurance in place to cover replacement of the property in the event of a loss.

## **SECTION 6: STATE OFFICE OVERSIGHT OF SERVICING ACTIVITIES**

Once the Servicing Office has conducted routine oversight and reviewed its portfolio, the State Office has a responsibility for additional oversight in a broad sense. The goals and responsibilities of State Offices are described below.

The State Office will use MFIS as the database for maintaining and analyzing project financial information as well as recording and tracking project supervisory activity and servicing efforts.

### **9.23 PORTFOLIO MANAGEMENT GOALS**

Proper asset management of the Agency's multi-family housing portfolio begins with a thorough evaluation of the entire portfolio to obtain a clear understanding of existing and potential problems. Close monitoring, timely follow-up, and a consistent administration of the regulations will be beneficial in the resolution of problems and will contribute to the stability of the program.

While during prior years the Agency has achieved success in the management of the portfolio, the Section 515 program continues to present challenges. These challenges require staff at all levels to be better prepared. Staff must be provided with training, resources, and support to meet these challenges. The mission, goals, and plan of action for effective loan servicing and portfolio management of the Section 515 program are described below. For tracking adherence to these goals, State Offices should look at the appropriate MFIS or AMAS report unless specified otherwise.

#### **A. Mission Statement**

The mission of the Section 515 program is to provide decent, safe, sanitary, and affordable housing to very low- and low-income rural residents. As the mission is realized, the program must also protect the Government's security and taxpayers' investment by ensuring effective asset management.

#### **B. Goals**

##### ***1. Reduce Receivership Periods to No More Than 12 Months***

The oversight process of a property held in receivership by the Agency requires close monitoring and supervision by the National Office and affected State Office and Servicing Office. This will include the review of property financial records such as monthly reports, year-end reports, and annual audits. Additionally, the staff is responsible for review and approval of the payment of certain expenses.

Several receivership properties have special needs and will need to be serviced within the parameters of a workout plan. Others will require sales and/or other liquidation plans. To transition out of the receivership, it will be necessary to focus efforts on obtaining new substitute general partners, transfers of ownership, or to liquidate accounts.

## ***2. Reduce Inventory Property Holding Periods to No More Than 12 Months***

Affected State Offices must review their inventory property portfolio and take necessary actions to effectively dispose of these properties. To accomplish this, all efforts should be given to marketing the properties, including reducing the price, sealed bids, or sale as a nonprogram property. All inventory properties should be managed and made ready for sale in the most expeditious manner using the authorities in 7 CFR part 3560, subpart K.

The National Office should be contacted for assistance in the sale of a property experiencing marketing difficulties. Reports to the National Office on the disposition of inventory properties will be requested on a case-by-case basis. States will be contacted to determine what efforts are being made to remove these properties from the inventory and what assistance can be provided by the National Office.

## ***3. Use Debt Settlement Authorities to Reduce Certain Long-Term Delinquencies***

A number of long-term delinquencies are the result of inactive accounts with loan balances remaining after the asset is liquidated (i.e., foreclosure, sale, or transfer for less than the debt, compromise offer, bankruptcy, etc.). These accounts need to be settled due to their negative impact on the overall multi-family housing delinquency rate. State Offices are to immediately request assistance of OGC, the Assistant U.S. Attorney, and/or the National Office when accounts in this category are determined to exist.

The National Office will run a monthly Financial and Operational Combined Uniform Single Report (FOCUS) report on inactive accounts to monitor progress and to determine whether National Office intervention is needed to expedite the process.

## ***4. Maintain a Delinquency Rate of Two Percent or Less***

All states with delinquency rates that exceed two percent are required to work with borrowers and take appropriate servicing actions to reduce their delinquency rates to two percent or less.

Borrowers who are consistently delinquent require aggressive servicing and counseling regarding late payments. If long-term delinquency is the result of pending litigation for liquidation, appropriate officials should be notified and encouraged to expedite such litigation. When states are experiencing difficulties with litigation officials or when the loan is part of a long-term work-out agreement, the National Office should be contacted for assistance.

Any state with average delinquency rates above the two percent national average will be closely monitored and contacted by the National Office to determine what efforts are being made to reduce the delinquency, and to identify whether assistance or training is needed. Delinquency status reports may be required from those states identified as having problems. Similarly, any states exhibiting a trend in increasing delinquencies may be required to submit an explanation or a plan of action. Any instances of Servicing Offices



holding payments and not processing them in a timely manner must be discontinued immediately. All payments are to be processed when received.

***5. Take Appropriate Action on All Operating Budgets and Utility Allowances Prior to the Beginning of a Project's Fiscal Year***

7 CFR 3560.303 states that project budgets and/or utility allowances must be prepared, reviewed, and approved in such a manner and timing that the approved budget and utility allowance, including changes, become effective at the beginning of a fiscal year of project operation. This includes the update of MFIS to indicate approval actions. All approval budgets are to be reviewed and approved on MFIS prior to the start of the borrower's fiscal year. If not, MFIS should indicate that a finding has been generated for either a "not received" or an "unacceptable" budget.

***6. Complete All Year-End Financial Reviews Within the Required Time Frame***

The "Actuals" listed on *Form RD 3560-7, Form RD 3560-10, Borrower Balance Sheet*, and the project audit are to be reviewed and any findings entered on MFIS within 60 days of their receipt. The borrower is to be notified of the results of the review and MFIS is to be updated accordingly.

***7. Complete All Annual Physical Inspections of All Properties***

The purpose of the annual physical walk-about inspection is to quickly determine whether there are potentially serious problems that may require immediate attention. In addition, unless previously addressed during the supervisory visit, a determination should be made if the common areas are accessible as required by Fair Housing Law. All necessary walk-about inspections must be completed. All findings and follow-ups must be entered into MFIS.

***8. Complete All Scheduled Supervisory Visits and Compliance Reviews as Required***

The supervisory visit includes the MFIS supervisory activities "triennial physical inspection," the "supervisory visit," and the "compliance review." The supervisory visit is the Agency's primary tool to complete in-depth analysis of the borrower operations with regard to Management Plan/Agreement, Fair Housing, tenant eligibility, file review, budget compliance, and building security and maintenance. The borrower is to be notified of findings and deficiencies and given a timetable to correct all problems. Any summary level findings must be entered into MFIS.

***9. Enter All Instances of Noncompliance on MFIS***

States reporting very few findings and violations per project are to review inspection analysis and reporting practices so that servicing routines are adequate to ensure proper discovery and reporting of borrower noncompliance. In addition, all states are to review and ensure that proper steps are completed to resolve findings and that those requiring additional resources to be resolved are identified as such.

***10. Review Multi-Family Housing Occupancy Statistics to Ensure Portfolio Exhibits Positive Trends***

State Directors and program managers with multi-family housing responsibilities are to review multi-family housing occupancy statistics on a quarterly basis to ensure that their portfolio exhibits positive trends in occupancy statistics. While market conditions may affect the accomplishment of positive trends, efforts must be made to use available resources as effectively as possible. These efforts include but are not limited to:

- A higher percentage of RA use;
- Lower vacancy rates; and
- A lower number of tenants overburdened by housing costs.

***11. Ensure MFIS Data Are Accurate, Consistent, Timely, and Complete and Used to Manage the Multi-Family Housing Program***

When used correctly, MFIS enables the Agency to effectively manage the multi-family housing portfolio and ensure the proper use of Federal housing resources. Staff at National, State, and Servicing Office levels have immediate access to portfolio information in order to make better program management decisions, and more effectively deploy limited resources. With the implementation of MFIS version 3, the ability to review portfolio activity now extends to borrowers and management agents as well as servicing office jurisdictions.

Effective management decisions rely on the accuracy, consistency, timeliness, and completeness of information such as a property's physical and financial condition, and the tracking and scheduling of supervisory activities and servicing efforts.

- State and Servicing Offices are required to input the current status of all servicing actions into MFIS. The State Office must monitor the MFIS activities of Servicing Offices to ensure that data are accurate, consistent, timely, and complete and that regulatory authorities are effectively used to manage the portfolio and determine that Agency resources are effectively used to obtain compliance.
- The National Office monitors portfolio management of properties through MFIS reports, as well as AMAS information. A quarterly National Office review will be used to measure the accomplishment of goals.

**C. Plan of Action**

The implementation of the Loan Servicing and Portfolio Management Goals and accuracy of all data are the responsibilities of the State Director. The State Director may assign one or more individuals the responsibility of monitoring servicing activities, follow-up, and problem resolution as outlined in this plan.

**D. Specific State Office Duties**

State Office staff must continuously monitor supervisory activities and borrower status to ensure that each project is receiving timely and effective supervision. MFIS should be used to accomplish these monitoring responsibilities.

State Directors must review summary results of each project's annual review through MFIS.

At least quarterly, State Offices must print out and review the MFIS project classification report. For projects classified with a D or C, State Offices must review the project's supervisory and servicing status on MFIS, using either reporting or online capabilities to determine the nature of the finding, violation, or default and the extent of the Loan Servicer's efforts to resolve the problem. The State Office should retain sufficient paper documentation of the annual review process to ensure that future reviewers will be able to determine that the appropriate annual review and coordination efforts were performed. State Directors are responsible to ensure that MFIS classifications accurately reflect the servicing status of their jurisdiction.

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**APPENDIX 1**  
**TEXT OF 7 CFR PART 3560**

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**APPENDIX 2**  
**TEXT OF 7 CFR PART 11**

designee, if the fund-raising program is multi-State or Nationwide.

(b) When used to promote 4-H educational programs, the 4-H Club name and emblem, subject to obtaining authorization as provided in these regulations, may be used on or associated with products and services sold in connection with 4-H fund-raising programs so long as no endorsement or the appearance of an endorsement of a commercial firm, product or service is either intended or effected. Tributes to 4-H contained on or associated with commercial products or services, when such products or services are used for the fund-raising activities, are subject to the requirements of this paragraph. All moneys received from 4-H fund-raising programs, except those necessary to pay reasonable expenses, must be expended to further the 4-H educational programs.

[52 FR 8432, Mar. 17, 1987, as amended at 60 FR 52293, Oct. 6, 1995]

## PARTS 9–10 [RESERVED]

### PART 11—NATIONAL APPEALS DIVISION

#### Subpart A—National Appeals Division Rules of Procedures

Sec.

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- 11.2 General statement.
- 11.3 Applicability.
- 11.4 Inapplicability of other laws and regulations.
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#### Subpart B—Organization And Functions

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- 11.30 General statement.
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APPENDIX A TO SUBPART C—LIST OF ADDRESSES

#### Subpart A—National Appeals Division Rules of Procedures

AUTHORITY: 5 U.S.C. 301; Title II, Subtitle H, Pub. L. 103–354, 108 Stat. 3228 (7 U.S.C. 6991 *et seq.*); Reorganization Plan No. 2 of 1953 (5 U.S.C. App.).

SOURCE: 64 FR 33373, June 23, 1999, unless otherwise noted.

#### § 11.1 Definitions.

For purposes of this part:

*Adverse decision* means an administrative decision made by an officer, employee, or committee of an agency that is adverse to a participant. The term includes a denial of equitable relief by an agency or the failure of an agency to issue a decision or otherwise act on the request or right of the participant within timeframes specified by agency program statutes or regulations or within a reasonable time if timeframes are not specified in such statutes or regulations. The term does not include a decision over which the Board of Contract Appeals has jurisdiction.

*Agency* means:

- (1) The Commodity Credit Corporation (CCC);
- (2) The Farm Service Agency (FSA);
- (3) The Federal Crop Insurance Corporation (FCIC);
- (4) The Natural Resources Conservation Service (NRCS);
- (5) The Risk Management Agency (RMA);
- (6) The Rural Business-Cooperative Service (RBS);
- (7) Rural Development (RD);
- (8) The Rural Housing Service (RHS);



(9) The Rural Utilities Service (RUS) (but not for programs authorized by the Rural Electrification Act of 1936 or the Rural Telephone Bank Act, 7 U.S.C. 901 *et seq.*);

(10) A State, county, or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act (16 U.S.C. 590h (b)(5)); and

(11) Any predecessor or successor agency to the above-named agencies, and any other agency or office of the Department which the Secretary may designate.

*Agency record* means all the materials maintained by an agency related to an adverse decision which are submitted to the Division by an agency for consideration in connection with an appeal under this part, including all materials prepared or reviewed by the agency during its consideration and decision-making process, but shall not include records or information not related to the adverse decision at issue. All materials contained in the agency record submitted to the Division shall be deemed admitted as evidence for purposes of a hearing or a record review under § 11.8.

*Agency representative* means any person, whether or not an attorney, who is authorized to represent the agency in an administrative appeal under this part.

*Appeal* means a written request by a participant asking for review by the National Appeals Division of an adverse decision under this part.

*Appellant* means any participant who appeals an adverse decision in accordance with this part. Unless separately set forth in this part, the term “appellant” includes an authorized representative.

*Authorized representative* means any person, whether or not an attorney, who is authorized in writing by a participant, consistent with § 11.6(c), to act for the participant in an administrative appeal under this part. The authorized representative may act on behalf of the participant except when the provisions of this part require action by the participant or appellant personally.

*Case record* means all the materials maintained by the Secretary related to

an adverse decision: The case record includes both the agency record and the hearing record.

*Days* means calendar days unless otherwise specified.

*Department* means the United States Department of Agriculture (USDA).

*Director* means the Director of the Division or a designee of the Director.

*Division* means the National Appeals Division established by this part.

*Equitable relief* means relief which is authorized under section 326 of the Food and Agriculture Act of 1962 (7 U.S.C. 1339a) and other laws administered by the agency.

*Ex parte communication* means an oral or written communication to any officer or employee of the Division with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports, or inquiries on Division procedure, in reference to any matter or proceeding connected with the appeal involved.

*Hearing*, except with respect to § 11.5, means a proceeding before the Division to afford a participant the opportunity to present testimony or documentary evidence or both in order to have a previous determination reversed and to show why an adverse determination was in error.

*Hearing Officer* means an individual employed by the Division who conducts the hearing and determines appeals of adverse decisions by any agency.

*Hearing record* means all documents, evidence, and other materials generated in relation to a hearing under § 11.8.

*Implement* means the taking of action by an agency of the Department in order fully and promptly to effectuate a final determination of the Division.

*Participant* means any individual or entity who has applied for, or whose right to participate in or receive, a payment, loan, loan guarantee, or other benefit in accordance with any program of an agency to which the regulations in this part apply is affected by a decision of such agency. The term does not include persons whose claim(s) arise under:

(1) Programs subject to various proceedings provided for in 7 CFR part 1;

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(2) Programs governed by Federal contracting laws and regulations (appealable under other rules and to other forums, including to the Department's Board of Contract Appeals under 7 CFR part 24);

(3) The Freedom of Information Act (appealable under 7 CFR part 1, subpart A);

(4) Suspension and debarment disputes, including, but not limited to, those falling within the scope of 7 CFR parts 1407 and 3017;

(5) Export programs administered by the Commodity Credit Corporation;

(6) Disputes between reinsured companies and the Federal Crop Insurance Corporation;

(7) Tenant grievances or appeals prosecutable under the provisions of 7 CFR part 1944, subpart L, under the multi-family housing program carried out by RHS;

(8) Personnel, equal employment opportunity, and other similar disputes with any agency or office of the Department which arise out of the employment relationship;

(9) The Federal Tort Claims Act, 28 U.S.C. 2671 *et seq.*, or the Military Personnel and Civilian Employees Claims Act of 1964, 31 U.S.C. 3721;

(10) Discrimination complaints prosecutable under the nondiscrimination regulations at 7 CFR parts 15, 15a, 15b, 15e, and 15f; or

(11) Section 361, *et seq.*, of the Agricultural Adjustment Act of 1938, as amended (7 U.S.C. 1361, *et seq.*) involving Tobacco Marketing Quota Review Committees.

*Record review* means an appeal considered by the Hearing Officer in which the Hearing Officer's determination is based on the agency record and other information submitted by the appellant and the agency, including information submitted by affidavit or declaration.

*Secretary* means the Secretary of Agriculture.

### § 11.2 General statement.

(a) This part sets forth procedures for proceedings before the National Appeals Division within the Department. The Division is an organization within the Department, subject to the general supervision of and policy direction by

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the Secretary, which is independent from all other agencies and offices of the Department, including Department officials at the state and local level. The Director of the Division reports directly to the Secretary of Agriculture. The authority of the Hearing Officers and the Director of the Division, and the administrative appeal procedures which must be followed by program participants who desire to appeal an adverse decision and by the agency which issued the adverse decision, are included in this part.

(b) Pursuant to section 212(e) of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Pub. L. 103-354 (the Act), 7 U.S.C. 6912(e), program participants shall seek review of an adverse decision before a Hearing Officer of the Division, and may seek further review by the Director, under the provisions of this part prior to seeking judicial review.

### § 11.3 Applicability.

(a) *Subject matter.* The regulations contained in this part are applicable to adverse decisions made by an agency, including, for example, those with respect to:

(1) Denial of participation in, or receipt of benefits under, any program of an agency;

(2) Compliance with program requirements;

(3) The making or amount of payments or other program benefits to a participant in any program of an agency; and

(4) A determination that a parcel of land is a wetland or highly erodible land.

(b) *Limitation.* The procedures contained in this part may not be used to seek review of statutes or USDA regulations issued under Federal Law.

### § 11.4 Inapplicability of other laws and regulations.

(a) Reserved.

(b) The Federal Rules of Evidence, 28 U.S.C. App., shall not apply to proceedings under this part.

**§ 11.5 Informal review of adverse decisions.**

(a) *Required informal review of FSA adverse decisions.* Except with respect to farm credit programs, a participant must seek an informal review of an adverse decision issued at the field service office level by an officer or employee of FSA, or by any employee of a county or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act, 16 U.S.C. 590h(b)(5), before NAD will accept an appeal of a FSA adverse decision. Such informal review shall be done by the county or area committee with responsibility for the adverse decision at issue. The procedures for requesting such an informal review before FSA are found in 7 CFR part 780. After receiving a decision upon review by a county or area committee, a participant may seek further informal review by the State FSA committee or may appeal directly to NAD under § 11.6(b).

(b) *Optional informal review.* With respect to adverse decisions issued at the State office level of FSA and adverse decisions of all other agencies, a participant may request an agency informal review of an adverse decision of that agency prior to appealing to NAD. Procedures for requesting such an informal review are found at 7 CFR part 780 (FSA), 7 CFR part 614 (NRCS), 7 CFR part 1900, subpart B (RUS), 7 CFR part 1900, subpart B (RBS), and 7 CFR part 1900, subpart B (RHS).

(c) *Mediation.* A participant also shall have the right to utilize any available alternative dispute resolution (ADR) or mediation program, including any mediation program available under title V of the Agricultural Credit Act of 1987, 7 U.S.C. 5101 *et seq.*, in order to attempt to seek resolution of an adverse decision of an agency prior to a NAD hearing. If a participant:

(1) Requests mediation or ADR prior to filing an appeal with NAD, the participant stops the running of the 30-day period during which a participant may appeal to NAD under § 11.6(b)(1), and will have the balance of days remaining in that period to appeal to NAD once mediation or ADR has concluded.

(2) Requests mediation or ADR after having filed an appeal to NAD under

§ 11.6(b), but before the hearing, the participant will be deemed to have waived his right to have a hearing within 45 days under § 11.8(c)(1) but shall have a right to have a hearing within 45 days after conclusion of mediation or ADR.

**§ 11.6 Director review of agency determination of appealability and right of participants to Division hearing.**

(a) *Director review of agency determination of appealability.* (1) Not later than 30 days after the date on which a participant receives a determination from an agency that an agency decision is not appealable, the participant must submit a written request personally signed by the participant to the Director to review the determination in order to obtain such review by the Director.

(2) The Director shall determine whether the decision is adverse to the individual participant and thus appealable or is a matter of general applicability and thus not subject to appeal, and will issue a final determination notice that upholds or reverses the determination of the agency. This final determination is not appealable. If the Director reverses the determination of the agency, the Director will notify the participant and the agency of that decision and inform the participant of his or her right to proceed with an appeal.

(3) The Director may delegate his or her authority to conduct a review under this paragraph to any subordinate official of the Division other than a Hearing Officer. In any case in which such review is conducted by such a subordinate official, the subordinate official's determination shall be considered to be the determination of the Director and shall be final and not appealable.

(b) *Appeals of adverse decisions.* (1) To obtain a hearing under § 11.8, a participant personally must request such hearing not later than 30 days after the date on which the participant first received notice of the adverse decision or after the date on which the participant receives notice of the Director's determination that a decision is appealable. In the case of the failure of an agency to act on the request or right of a recipient, a participant personally must

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request such hearing not later than 30 days after the participant knew or reasonably should have known that the agency had not acted within the timeframes specified by agency program regulations, or, where such regulations specify no timeframes, not later than 30 days after the participant reasonably should have known of the agency's failure to act.

(2) A request for a hearing shall be in writing and personally signed by the participant, and shall include a copy of the adverse decision to be reviewed, if available, along with a brief statement of the participant's reasons for believing that the decision, or the agency's failure to act, was wrong. The participant also shall send a copy of the request for a hearing to the agency, and may send a copy of the adverse decision to be reviewed to the agency, but failure to do either will not constitute grounds for dismissal of the appeal. Instead of a hearing, the participant may request a record review.

(c) If a participant is represented by an authorized representative, the authorized representative must file a declaration with NAD, executed in accordance with 28 U.S.C. 1746, stating that the participant has duly authorized the declarant in writing to represent the participant for purposes of a specified adverse decision or decisions, and attach a copy of the written authorization to the declaration.

### § 11.7 Ex parte communications.

(a)(1) At no time between the filing of an appeal and the issuance of a final determination under this part shall any officer or employee of the Division engage in *ex parte* communications regarding the merits of the appeal with any person having any interest in the appeal pending before the Division, including any person in an advocacy or investigative capacity. This prohibition does not apply to:

(i) Discussions of procedural matters related to an appeal; or

(ii) Discussions of the merits of the appeal where all parties to the appeal have been given notice and an opportunity to participate.

(2) In the case of a communication described in paragraph (a)(1)(ii) of this section, a memorandum of any such

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discussion shall be included in the hearing record.

(b) No interested person shall make or knowingly cause to be made to any officer or employee of the Division an *ex parte* communication relevant to the merits of the appeal.

(c) If any officer or employee of the Division receives an *ex parte* communication in violation of this section, the one who receives the communication shall place in the hearing record:

(1) All such written communications;

(2) Memoranda stating the substance of all such oral communications; and

(3) All written responses to such communications, and memoranda stating the substance of any oral responses thereto.

(d) Upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this section the Hearing Officer or Director may, to the extent consistent with the interests of justice and the policy of the underlying program, require the party to show cause why such party's claim or interest in the appeal should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation.

### § 11.8 Division hearings.

(a) *General rules.* (1) The Director, the Hearing Officer, and the appellant shall have access to the agency record of any adverse decision appealed to the Division for a hearing. Upon request by the appellant, the agency shall provide the appellant a copy of the agency record.

(2) The Director and Hearing Officer shall have the authority to administer oaths and affirmations, and to require, by subpoena, the attendance of witnesses and the production of evidence. A Hearing Officer shall obtain the concurrence of the Director prior to issuing a subpoena.

(i) A subpoena requiring the production of evidence may be requested and issued at any time while the case is pending before the Division.

(ii) An appellant or an agency, acting through any appropriate official, may request the issuance of a subpoena requiring the attendance of a witness by submitting such a request in writing at least 14 days before the scheduled date of a hearing. The Director or Hearing

Officer shall issue a subpoena at least 7 days prior to the scheduled date of a hearing.

(iii) A subpoena shall be issued only if the Director or a Hearing Officer determined that:

(A) For a subpoena of documents, the appellant or the agency has established that production of documentary evidence is necessary and is reasonably calculated to lead to information which would affect the final determination or is necessary to fully present the case before the Division; or

(B) For a subpoena of a witness, the appellant or the agency has established that either a representative of the Department or a private individual possesses information that is pertinent and necessary for disclosure of all relevant facts which could impact the final determination, that the information cannot be obtained except through testimony of the person, and that the testimony cannot be obtained absent issuance of a subpoena.

(iv) The party requesting issuance of a subpoena shall arrange for service. Service of a subpoena upon a person named therein may be made by registered or certified mail, or in person. Personal service shall be made by personal delivery of a copy of the subpoena to the person named therein by any person who is not a party and who is not less than 18 years of age. Proof of service shall be made by filing with the Hearing Officer or Director who issued the subpoena a statement of the date and manner of service and of the names of the persons served, certified by the person who made the service in person or by return receipts for certified or registered mail.

(v) A party who requests that a subpoena be issued shall be responsible for the payment of any reasonable travel and subsistence costs incurred by the witness in connection with his or her appearance and any fees of a person who serves the subpoena in person. The Department shall pay the costs associated with the appearance of a Department employee whose role as a witness arises out of his or her performance of official duties, regardless of which party requested the subpoena. The failure to make payment of such charges on demand may be deemed by the Hear-

ing Officer or Director as sufficient ground for striking the testimony of the witness and the evidence the witness has produced.

(vi) If a person refuses to obey a subpoena, the Director, acting through the Office of the General Counsel of the Department and the Department of Justice, may apply to the United States District Court in the jurisdiction where that person resides to have the subpoena enforced as provided in the Federal Rules of Civil Procedure (28 U.S.C. App.).

(3) Testimony required by subpoena pursuant to paragraph (a)(2) of this section may, at the discretion of the Director or a Hearing Officer, be presented at the hearing either in person or telephonically.

(b) *Hearing procedures applicable to both record review and hearings.* (1) Upon the filing of an appeal under this part of an adverse decision by any agency, the agency promptly shall provide the Division with a copy of the agency record. If requested by the applicant prior to the hearing, a copy of such agency record shall be provided to the appellant by the agency within 10 days of receipt of the request by the agency.

(2) The Director shall assign the appeal to a Hearing Officer and shall notify the appellant and agency of such assignment. The notice also shall advise the appellant and the agency of the documents required to be submitted under paragraph (c)(2) of this section, and notify the appellant of the option of having a hearing by telephone.

(3) The Hearing Officer will receive evidence into the hearing record without regard to whether the evidence was known to the agency officer, employee, or committee making the adverse decision at the time the adverse decision was made.

(c) *Procedures applicable only to hearings.* (1) Upon a timely request for a hearing under § 11.8(b), an appellant has the right to have a hearing by the Division on any adverse decision within 45 days after the date of receipt of the request for the hearing by the Division.

(2) The Hearing Officer shall set a reasonable deadline for submission of the following documents:

(i) By the appellant;

(A) A short statement of why the decision is wrong;

(B) A copy of any document not in the agency record that the appellant anticipates introducing at the hearing; and

(C) A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

(ii) By the agency:

(A) A copy of the adverse decision challenged by the appellant;

(B) A written explanation of the agency's position, including the regulatory or statutory basis therefor;

(C) A copy of any document not in the agency record that the agency anticipates introducing at the hearing; and

(D) A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

(3) Not less than 14 days prior to the hearing, the Division must provide the appellant, the authorized representative, and the agency a notice of hearing specifying the date, time, and place of the hearing. The hearing will be held in the State of residence of the appellant, as determined by the Hearing Officer, or at a location that is otherwise convenient to the appellant, the agency, and the Division. The notice also shall notify all parties of the right to obtain an official record of the hearing.

(4) Pre-hearing conference. Whenever appropriate, the Hearing Officer shall hold a pre-hearing conference in order to attempt to resolve the dispute or to narrow the issues involved. Such pre-hearing conference shall be held by telephone unless the Hearing Officer and all parties agree to hold such conference in person.

(5) Conduct of the hearing. (i) A hearing before a Hearing Officer will be in person unless the appellant agrees to a hearing by telephone.

(ii) The hearing will be conducted by the Hearing Officer in the manner determined by the Division most likely to obtain the facts relevant to the matter or matters at issue. The Hearing Officer will allow the presentation of evidence at the hearing by any party without regard to whether the evidence was known to the officer, employee, or committee of the agency making the adverse decision at the time the ad-

verse decision was made. The Hearing Officer may confine the presentation of facts and evidence to pertinent matters and exclude irrelevant, immaterial, or unduly repetitious evidence, information, or questions. Any party shall have the opportunity to present oral and documentary evidence, oral testimony of witnesses, and arguments in support of the party's position; controvert evidence relied on by any other party; and question all witnesses. When appropriate, agency witnesses requested by the appellant will be made available at the hearing. Any evidence may be received by the Hearing Officer without regard to whether that evidence could be admitted in judicial proceedings.

(iii) An official record shall be made of the proceedings of every hearing. This record will be made by an official tape recording by the Division. In addition, either party may request that a verbatim transcript be made of the hearing proceedings and that such transcript shall be made the official record of the hearing. The party requesting a verbatim transcript shall pay for the transcription service, shall provide a certified copy of the transcript to the Hearing Officer free of charge, and shall allow any other party desiring to purchase a copy of the transcript to order it from the transcription service.

(6) Absence of parties. (i) If at the time scheduled for the hearing either the appellant or the agency representative is absent, and no appearance is made on behalf of such absent party, or no arrangements have been made for rescheduling the hearing, the Hearing Officer has the option to cancel the hearing unless the absent party has good cause for the failure to appear. If the Hearing Officer elects to cancel the hearing, the Hearing Officer may:

(A) Treat the appeal as a record review and issue a determination based on the agency record as submitted by the agency and the hearing record developed prior to the hearing date;

(B) Accept evidence into the hearing record submitted by any party present at the hearing (subject to paragraph (c)(6)(ii) of this section), and then issue a determination; or

(C) Dismiss the appeal.

(ii) When a hearing is cancelled due to the absence of a party, the Hearing Officer will add to the hearing record any additional evidence submitted by any party present, provide a copy of such evidence to the absent party or parties, and allow the absent party or parties 10 days to provide a response to such additional evidence for inclusion in the hearing record.

(iii) Where an absent party has demonstrated good cause for the failure to appear, the Hearing Officer shall reschedule the hearing unless all parties agree to proceed without a hearing.

(7) *Post-hearing procedure.* The Hearing Officer will leave the hearing record open after the hearing for 10 days, or for such other period of time as the Hearing Officer shall establish, to allow the submission of information by the appellant or the agency, to the extent necessary to respond to new facts, information, arguments, or evidence presented or raised at the hearing. Any such new information will be added by the Hearing Office to the hearing record and sent to the other party or parties by the submitter of the information. The Hearing Officer, in his or her discretion, may permit the other party or parties to respond to this post-hearing submission.

(d) *Interlocutory review.* Interlocutory review by the Director of rulings of a Hearing Officer are not permitted under the procedures of this part.

(e) *Burden of proof.* The appellant has the burden of proving that the adverse decision of the agency was erroneous by a preponderance of the evidence.

(f) *Timing of issuance of determination.* The Hearing Officer will issue a notice of the determination on the appeal to the named appellant, the authorized representative, and the agency not later than 30 days after a hearing or the closing date of the hearing record in cases in which the Hearing Officer receives additional evidence from the agency or appellant after a hearing. In the case of a record review, the Hearing Officer will issue a notice of determination within 45 days of receipt of the appellant's request for a record review. Upon the Hearing Officer's request, the Director may establish an earlier or later deadline. A notice of determination shall be accompanied by a copy of

the procedures for filing a request for Director review under § 11.9. If the determination is not appealed to the Director for review under § 11.9, the notice provided by the Hearing Officer shall be considered to be a notice of a final determination under this part.

#### **§ 11.9 Director review of determinations of Hearing Officers.**

(a) *Requests for Director review.* (1) Not later than 30 days after the date on which an appellant receives the determination of a Hearing Officer under § 11.8, the appellant must submit a written request, signed personally by the named appellant, to the Director to review the determination in order to be entitled to such review by the Director. Such request shall include specific reasons why the appellant believes the determination is wrong.

(2) Not later than 15 business days after the date on which an agency receives the determination of a Hearing Officer under § 11.8, the head of the agency may make a written request that the Director review the determination. Such request shall include specific reasons why the agency believes the determination is wrong, including citations of statutes or regulations that the agency believes the determination violates. Any such request may be made by the head of an agency only, or by a person acting in such capacity, but not by any subordinate officer of such agency.

(3) A copy of a request for Director review submitted under this paragraph shall be provided simultaneously by the submitter to each party to the appeal.

(b) *Notification of parties.* The Director promptly shall notify all parties of receipt of a request for review.

(c) *Responses to request for Director review.* Other parties to an appeal may submit written responses to a request for Director review within 5 business days from the date of receipt of a copy of the request for review.

(d) *Determination of Director.* (1) The Director will conduct a review of the determination of the Hearing Officer using the agency record, the hearing record, the request for review, any responses submitted under paragraph (c)

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of this section, and such other arguments or information as may be accepted by the Director, in order to determine whether the decision of the Hearing Officer is supported by substantial evidence. Based on such review, the Director will issue a final determination notice that upholds, reverses, or modifies the determination of the Hearing Officer. The Director's determination upon review of a Hearing Officer's decision shall be considered to be the final determination under this part and shall not be appealable. However, if the Director determines that the hearing record is inadequate or that new evidence has been submitted, the Director may remand all or a portion of the determination to the Hearing Officer for further proceedings to complete the hearing record or, at the option of the Director, to hold a new hearing.

(2) The Director will complete the review and either issue a final determination or remand the determination not later than—

(i) 10 business days after receipt of the request for review, in the case of a request by the head of an agency; or

(ii) 30 business days after receipt of the request for review, in the case of a request by an appellant.

(3) In any case or any category of cases, the Director may delegate his or her authority to conduct a review under this section to any Deputy or Assistant Directors of the Division. In any case in which such review is conducted by a Deputy or Assistant Director under authority delegated by the Director, the Deputy or Assistant Director's determination shall be considered to be the determination of the Director under this part and shall be final and not appealable.

(e) *Equitable relief.* In reaching a decision on an appeal, the Director shall have the authority to grant equitable relief under this part in the same manner and to the same extent as such authority is provided an agency under applicable laws and regulations.

### § 11.10 Basis for determinations.

(a) In making a determination, the Hearing Officers and the Director are not bound by previous findings of facts

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on which the agency's adverse decision was based.

(b) In making a determination on the appeal, Hearing Officers and the Director shall ensure that the decision is consistent with the laws and regulations of the agency, and with the generally applicable interpretations of such laws and regulations.

(c) All determinations of the Hearing Officers and the Director must be based on information from the case record, laws applicable to the matter at issue, and applicable regulations published in the FEDERAL REGISTER and in effect on the date of the adverse decision or the date on which the acts that gave rise to the adverse decision occurred, whichever date is appropriate under the applicable agency program laws and regulations.

### § 11.11 Reconsideration of Director determinations.

(a) Reconsideration of a determination of the Director may be requested by the appellant or the agency within 10 days of receipt of the determination. The Director will not consider any request for reconsideration that does not contain a detailed statement of a material error of fact made in the determination, or a detailed explanation of how the determination is contrary to statute or regulation, which would justify reversal or modification of the determination.

(b) The Director shall issue a notice to all parties as to whether a request for reconsideration meets the criteria in paragraph (a) of this section. If the request for reconsideration meets such criteria, the Director shall include a copy of the request for reconsideration in the notice to the non-requesting parties to the appeal. The non-requesting parties shall have 5 days from receipt of such notice from the Director to file a response to the request for reconsideration with the Director.

(c) The Director shall issue a decision on the request for reconsideration within 5 days of receipt of responses from the non-requesting parties. If the Director's decision upon reconsideration reverses or modifies the final determination of the Director rendered under § 11.9(d), the Director's decision on reconsideration will become the



final determination of the Director under § 11.9(d) for purposes of this part.

**§ 11.12 Effective date and implementation of final determinations of the Division.**

(a) On the return of a case to an agency pursuant to the final determination of the Division, the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.

(b) A final determination will be effective as of the date of filing of an application, the date of the transaction or event in question, or the date of the original adverse decision, whichever is applicable under the applicable agency program statutes or regulations.

**§ 11.13 Judicial review.**

(a) A final determination of the Division shall be reviewable and enforceable by any United States District Court of competent jurisdiction in accordance with chapter 7 of title 5, United States Code.

(b) An appellant may not seek judicial review of any agency adverse decision appealable under this part without receiving a final determination from the Division pursuant to the procedures of this part.

**§ 11.14 Filing of appeals and computation of time.**

(a) An appeal, a request for Director Review, or any other document will be considered "filed" when delivered in writing to the Division, when postmarked, or when a complete facsimile copy is received by the Division.

(b) Whenever the final date for any requirement of this part falls on a Saturday, Sunday, Federal holiday, or other day on which the Division is not open for the transaction of business during normal working hours, the time for filing will be extended to the close of business on the next working day.

(c) The time for filing an appeal, a request for Director review, or any other document expires at 5:00 p.m. local time at the office of the Division to which the filing is submitted on the last day on which such filing may be made.

**§ 11.15 Participation of third parties and interested parties in Division proceedings.**

In two situations, parties other than the appellant or the agency may be interested in participating in Division proceedings. In the first situation, a Division proceeding may in fact result in the adjudication of the rights of a third party, e.g., an appeal of a tenant involving a payment shared with a landlord, an appeal by one recipient of a portion of a payment shared by multiple parties, an appeal by one heir of an estate. In the second situation, a party may desire to receive notice of and perhaps participate in an appeal because of the derivative impact the appeal determination will have on that party, e.g., guaranteed lenders and reinsurance companies. The provisions in this section set forth rules for the participation of such third and interested parties.

(a) *Third parties.* When an appeal is filed, the Division shall notify any potential third party whose rights may be adjudicated of its right to participate as an appellant in the appeal. This includes the right to seek Director review of the Hearing Officer determination. Such third parties may be identified by the Division itself, by an agency, or by the original appellant. The Division shall issue one notice to the third party of its right to participate, and if such party declines to participate, the Division determination will be binding as to that third party as if it had participated. For purposes of this part, a third party includes any party for which a determination of the Division could lead to an agency action on implementation that would be adverse to the party thus giving such party a right to a Division appeal.

(b) *Interested parties.* With respect to a participant who is a borrower under a guaranteed loan or an insured under a crop insurance program, the respective guaranteed lender or reinsurance company having an interest in a participant's appeal under this part may participate in the appeal as an interested party, but such participation does not confer the status of an appellant upon the guaranteed lender or reinsurance

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company such that it may request Director review of a final determination of the Division.

### Subpart B—Organization And Functions

AUTHORITY: 5 U.S.C. 301 and 552; 7 CFR part 2.

SOURCE: 63 FR 44773, Aug. 21, 1998, unless otherwise noted.

#### § 11.20 General statement.

This subpart provides guidance for the general public as to the organization and functions of NAD.

#### § 11.21 Organization.

NAD was established on October 13, 1994. Delegation of authority to the Director, NAD, appears at § 2.34 of this title. The organization is comprised of three regional offices: Eastern Regional Office, Indianapolis, Indiana; Southern Regional Office, Memphis, Tennessee; and Western Regional Office, Lakewood, Colorado; and the headquarters staff located in Alexandria, Virginia. NAD is headed by a Director. NAD is assigned responsibility for certain administrative appeals as set forth in subpart A of this part.

#### § 11.22 Functions.

(a) *Director*. Provides executive direction for NAD. The Director is responsible for developing and implementing nationwide plans, policies, and procedures for the timely and orderly hearing and disposition of appeals filed by individuals or entities in accordance with subpart A of this part. The Director will respond to all FOIA requests concerning appeal decisions and case records maintained by NAD.

(b) *Deputy Director for Hearings and Administration*. Responsible for all administrative functions of NAD, including budget, correspondence, personnel, travel, equipment, and regulation review and development.

(c) *Deputy Director for Planning, Training, and Quality Control*. Responsible for NAD strategic planning, including the organization's compliance with the Government Performance and Results Act, Pub. L. 103-62, employee training, and the establishment and

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maintenance of a quality assurance program.

(d) *Assistant Directors for Regions*. Responsible for oversight of the adjudication process for cases filed in the NAD regional offices. Assistant Directors ensure statutory and administrative time frames are met, and oversee the administrative functions, training, and supervision of the support staff located in the regional offices and the large dispersed staff of professional hearing officers located throughout the regions. The three regional offices serve as the custodian for all NAD determinations and case records.

### Subpart C—Availability of Information to the Public

AUTHORITY: 5 U.S.C. 301 and 552; 7 CFR 1.1-1.16.

SOURCE: 63 FR 44774, Aug. 21, 1998, unless otherwise noted.

#### § 11.30 General statement.

This subpart implements the regulations of the Secretary of Agriculture at 7 CFR 1.1 through 1.16 concerning FOIA (5 U.S.C. 552). The Secretary's regulations, as implemented by the regulations in this part, govern the availability of the records of NAD to the public.

#### § 11.31 Public inspection and copying.

Section 1.5 of this title requires that certain materials be made available by each USDA agency for public inspection and copying in accordance with 5 U.S.C. 522(a)(2). Members of the public wishing to gain access to these NAD records should write to the appropriate address shown in Appendix A of this subpart.

#### § 11.32 Initial requests for records.

(a) Requests for NAD records should be in writing and addressed to the NAD official having custody of the records desired as indicated in § 11.22(d). Addresses are found in Appendix A of this subpart. In his or her petition, the requester may ask for a fee waiver if there is likely to be a charge for the requested information. The criteria for waiver of fees are found in section 6 of appendix A, subpart A of part 1 of this

title. All requests for records shall be deemed to have been made pursuant to FOIA, regardless of whether FOIA is specifically mentioned. To facilitate processing of a request, the phrase "FOIA REQUEST" should be placed in capital letters on the front of the envelope.

(b) A request must reasonably describe records to enable NAD personnel to locate them with reasonable effort. Where possible, a requester should supply specific information, such as dates, titles, appellant name or appeal number, that may help identify the records. If the request relates to a matter in pending litigation, the court and its location should be identified.

(c) If NAD determines that a request does not reasonably describe the records, it shall inform the requester of this fact and extend the requester an opportunity to clarify the request or to confer promptly with knowledgeable NAD personnel to attempt to identify the records he or she is seeking. The "date of receipt" in such instances, for purposes of §1.12(a) of this title, shall be the date of receipt of the amended or clarified request.

(d) Nothing in this subpart shall be interpreted to preclude NAD from honoring an oral request for information, but if the requester is dissatisfied with the response, the NAD official involved shall advise the requester to submit a written request in accordance with paragraph (a) of this section. The "date of receipt" of such a request for purposes of §1.12(a) of this title shall be the date of receipt of the written request. For recordkeeping purposes, the NAD official responding to an oral request for information may ask the requester to also submit his or her request in writing.

(e) If a request for records or a fee waiver under this subpart is denied, the person making the request shall have the right to appeal the denial. Requesters also may appeal NAD decisions regarding a requester's status for purposes of fee levels under section 5 of Appendix A, subpart A of part 1 of this title. All appeals must be in writing and addressed to the official designated in §11.33. To facilitate processing of an appeal, the phrase "FOIA APPEAL"

should be placed in capital letters on the front of the envelope.

(f) NAD shall develop and maintain a record of all written and oral FOIA requests and FOIA appeals received by NAD, which shall include, in addition to any other information, the name of the requester, brief summary of the information requested, an indication of whether the request or appeal was denied or partially denied, the FOIA exemption(s) cited as the basis for any denials, and the amount of fees associated with the request or appeal.

### §11.33 Appeals.

Any person whose initial FOIA request is denied in whole or in part may appeal that denial to the Director, National Appeals Division, U.S. Department of Agriculture, 3101 Park Center Drive, Suite 1113, Alexandria, Virginia 22302. The Director will make the final determination on the appeal.

#### APPENDIX A TO SUBPART C OF PART 11— LIST OF ADDRESSES

This list provides the titles and mailing addresses of officials who have custody of NAD records. This list also identifies the normal working hours, Monday through Friday, excluding holidays, during which public inspection and copying of certain kinds of records is permitted.

Director, National Appeals Division, U.S. Department of Agriculture, 3101 Park Center Drive, Suite 1113, Alexandria, Virginia 22302, Hours: 8 a.m.-5 p.m.

Regional Assistant Director, Eastern Region, National Appeals Division, U.S. Department of Agriculture, 3500 DePauw Boulevard, Suite 2052, Indianapolis, Indiana 46268, Hours: 8 a.m.-5 p.m.

Regional Assistant Director, Southern Region, National Appeals Division, U.S. Department of Agriculture, 7777 Walnut Grove Road, LLB-1, Memphis, Tennessee 38120, Hours: 8 a.m.-5 p.m.

Regional Assistant Director, Western Region, National Appeals Division, U.S. Department of Agriculture, 755 Parfet Street, Suite 494, Lakewood, Colorado 80215-5506, Hours: 8 a.m.-5 p.m.

## PART 12—HIGHLY ERODIBLE LAND AND WETLAND CONSERVATION

### Subpart A—General Provisions

Sec.

12.1 General.

12.2 Definitions.

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## APPENDIX 3

### FORMS REFERENCED IN THIS HANDBOOK

Below is a list of forms that are mentioned in the text of this handbook. Since the Rural Development forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (<http://rdinit.usda.gov/regs>) for their own reference.

*Form FEMA 81-93, Standard Flood Hazard Determination*  
*Form G-845S, Verification for SAVE Agencies*  
*Form HUD 935.2, Affirmative Fair Housing Marketing Plan*  
*Form RD 400-8, Compliance Review*  
*Form RD 426-2, Property Insurance Mortgagee Clause (w/o control)*  
*Form RD 444-27A, Amendment to RA Agreement*  
*Form RD 1924-13, Estimate and Certificate of Actual Cost*  
*Form RD 1944-37, Previous Participation Certification*  
*Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*  
*Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*  
*Form RD 3560-8, Tenant Certification*  
*Form RD 3560-9, Interest Credit and Rental Assistance Agreement*  
*Form RD 3560-10, Borrower Balance Sheet*  
*Form RD 3560-11, MFH Physical Inspection Report*  
*Form RD 3560-12, Request for Authorization to Withdraw Reserve Funds*  
*Form RD 3560-13, Management Certification*  
*Form RD 3560-19, MFH Advice of Mortgaged Real Estate Acquired*  
*Form RD 3560-27, Rental Assistance Agreement*  
*Form RD 3560-29, Notice of Payment Due Report*  
*Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate*  
*Form RD 3560-37, Previous Participation Certification*  
*Form RD 3560-51, Obligation Fund Analysis*  
*Form RD 3560-52, Promissory Note*  
*Form RD 3560-53, Cancellation of U.S. Treasury Check and/or Obligation*  
*Form RD 3560-55, MFH Transfer of RA*

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## **APPENDIX 4**

### **HANDBOOK LETTERS REFERENCED IN THIS HANDBOOK**

*Handbook Letter 201 (3560), Letter of Priority Entitlement (LOPE)*

*Handbook Letter 202 (3560), Notification Letter for Supervisory Visit*

REFERENCE: HB-2-3560 Chapter 6

PURPOSE: Letter of Priority Entitlement (LOPE)

---

RURAL DEVELOPMENT  
[LOCATION]

DATE: *[insert today's date]*

SUBJECT: LETTER OF PRIORITY ENTITLEMENT (LOPE) FOR:

*[insert Name of Tenant/Family]*  
*[insert Tenant/Family's Address]*

Dear Tenant:

*[Suggested language for prepayment]*

The Owner(s) of *[name, address to include city, state and zip code of prepaying property]* has been granted permission to pay off their Rural Development Loan on *[name of property]*. This means that you are entitled to priority placement on the waiting list of any Rural Development Section 515 Rural Rental Housing property, should you be displaced due to of rent increases, as a result this prepayment. This letter may also serve to give you preference in non-Rural Development properties and rental programs served by the Department of Housing and Urban Development (HUD) if their occupancy policy allows. Please present this Letter of Priority Entitlement to your new landlord.

*[Or]*

As a result of the *[insert description of natural disaster, uninhabitable situation]* for the above reference property you are entitled to priority for placement on waiting lists of any 515 rural rental housing property, that has units for which you are eligible to occupy. There is no geographic limit on this entitlement. This letter may also serve to give you preference in non-Rural Development properties and rental programs served by the Department of Housing and Urban Development (HUD) if their occupancy policy allows. Please present this Letter of Priority Entitlement to your new landlord.  
Dear Rural Development or Housing and Urban Development (HUD) Property Owners:



The tenant named above is currently living in the Rural Development 515 multifamily housing property for which *[insert reason for LOPE letter i.e., authorized prepayment, or uninhabitable or natural disaster]*. This letter must be used within 60 days from the above date to give this tenant/family priority placement on your waiting list(s). The only other tenants who may receive priority over this tenant/family are those who have already entered your waiting list with a letter similar to this one or handicapped tenants who need the particular design features of a vacant apartment. The above named tenant/family is to remain in this position on your waiting list until they receive an apartment or the list is purged in accordance with a Rural Development-approved policy. After 60 days, they may continue to be placed on waiting lists for apartments for which they are eligible, but without priority.

NOTE: This priority places the above-named tenant/family at the top of all waiting lists in your properties, regardless of other priorities (such as income) and eligibility's for apartment size so long as your property has at least one apartment, presently occupied or not, for which this tenant/family is eligible. If this tenant/family occupies an apartment for which size or type they are not eligible for, the lease must read that this tenant/family will move to the first appropriate apartment available.

If this tenant/family is receiving Rental Assistance (RA) at the prepaying property, they will continue to receive RA at your property if it is a property operating under Plan II of the Section 515 program. If you do not have a unit of unused RA to assign to this tenant/family, you will be allocated one unit for this purpose.

If the current security deposit is returnable to the tenant/family, but has not been released to the tenant/family by the move-in date, it should be assigned directly to you by the prepaying property if allowed by the laws of the State. Otherwise, you may have to wait to receive the security deposit until it is returned to this tenant/family.

Tenant Data:

Composition of Family \_\_\_\_\_  
Tenant/Family/Elderly/Handicapped \_\_\_\_\_  
Unit-Size Eligibility \_\_\_\_\_  
Last Verified Income \_\_\_\_\_ as of \_\_\_\_\_  
RA: \_\_\_\_\_  
Section 8 Voucher: \_\_\_\_\_  
Current Security Deposit: \_\_\_\_\_

If you have any questions, please contact the Servicing Office at the address below:

*[RD Servicing Official signature and title]*

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Notification Letter for Supervisory Visit

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RURAL DEVELOPMENT  
[LOCATION]

Date: [insert today's date]

[Name of borrower]

[Address of borrower]

Dear [insert borrower's last name(s), (Mr., Ms., Mrs.)]

Rural Development Servicing Office staff will be conducting a supervisory visit of [name of rural rental or cooperative project] located in the town of [city].

Your project review is scheduled for [date of visit], at [time] in the project [office or manager's office]. We would like to meet with the project [management agent, owner, board of directors or board president, bookkeeper, resident manager, etc.] at the time shown.

Please have the following records available for review:

- All project account records including bookkeeper records and others pertaining to the project, such as:
  - ◇ General operating account
  - ◇ Tax and insurance escrow accounts
  - ◇ Reserve account
  - ◇ Security deposit or membership fee account
  - ◇ Patronage capital account (if applicable)
  - ◇ Management reserve account, (if applicable)
  - ◇ Checking account
  - ◇ Savings account
- The individual tenant or member files

- Waiting lists
  - ◊ Applications of those on the waiting lists
  - ◊ Applications of those determined ineligible for occupancy
- Management plan and management agreement/certification
- Evidence of the effort made in the last 12 months to meet the objectives in your Affirmative Fair Housing Marketing Plan.
- A copy of the tenant lease or occupancy agreement used, with written evidence of your attorney's approval, RHS's approval, and HUD's approval (if HUD Section 8 is utilized).
- The mailing address for the project

If you have any questions, please contact this office.

Sincerely,

*[Rural Development servicing official's signature and title]*

ENCLOSURE

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## APPENDIX 5

### Civil Rights Laws' Accessibility Requirements That Apply to the Multi-Family Housing (MFH) Program

*The Civil Rights laws covering accessibility have different implementation responsibilities but all provide for the protection and nondiscrimination of individuals with disabilities. Borrowers who fail to meet these requirements will make themselves vulnerable to damages and can be required to retrofit their facilities at their expense.*

#### **Section 504 of the Rehabilitation Act of 1973**

The Department of Agriculture (USDA) implemented section 504 of the Rehabilitation Act of 1973, on June 10, 1982, by issuing 7 CFR 15b. Section 504's purpose is to assure that no otherwise qualified person with a disability is solely by reason of his or her disability excluded from benefits, or subjected to discrimination under any Federally assisted program or activity.

**Compliance Standard:** The Uniform Federal Accessibility Standards (UFAS). For more information see [www.access-board.gov/ufas/ufas-html/ufas.htm](http://www.access-board.gov/ufas/ufas-html/ufas.htm).

#### **Highlights of section 504 Requirements**

*In MFH projects ready for occupancy **on or before June 10, 1982:***

- Borrowers are encouraged to make 5 percent of the units fully accessible. (Structural changes in existing facilities may not be needed where other methods are effective in achieving program accessibility, such as reassignment of services to accessible buildings, assignment of aides to users, and delivery of services at alternate accessible sites.  
Borrowers are to use the method that provides the most integrated setting.)
- Borrowers must conduct self-evaluations and, if needed, develop transition plans.  
(Borrowers must make these documents available to the public or Agency upon request.)
- Borrowers must make common areas accessible when financially and structurally feasible.  
(Common areas include mailboxes, office, community room, trash area, playground, and laundry facilities.)
- When a qualified individual with a disability applies for admission, borrowers must make the unit accessible and usable to the individual.

*In MFH projects ready for occupancy **after June 10, 1982:***

- 5 percent of the units, or one unit, whichever is greater, must be fully accessible.
- The mix of accessible units is to be comparable to the variety of other project units (i.e., 1, 2, and 3 bedrooms).
- All common areas must be accessible per UFAS.
- Borrowers found in non-compliance with accessibility requirements of Civil Rights laws may be required to conduct "self-evaluations" and prepare "transition plans" or respond to other administrative and legal actions.

### **Fair Housing Act**

The Department of Housing and Urban Development (HUD) issued 24 CFR100.205 to implement the Fair Housing Act, as amended, on January 23, 1989. The Fair Housing Act requires that buildings be constructed to be accessible to individuals with disabilities.

**Compliance Standard:** The Fair Housing Act/Accessibility Guidelines (FHA/AG). For more information see [www.hud.gov:80/library/bookshelf09/fhefhag.cfm](http://www.hud.gov:80/library/bookshelf09/fhefhag.cfm).

### **Highlights of Fair Housing Act Requirements**

*In MFH projects ready for occupancy **on or before March 13, 1991:***

- FHA/AG architectural requirements do not apply, even during project rehabilitation.

*In MFH projects ready for occupancy **after March 13, 1991:***

- All first floor ground units in buildings with four or more dwelling units must be designed and constructed in a manner that is adaptable to individuals with disabilities.
- All units must be adaptable if there is an elevator.
- Covered MFH projects must have:
  1. An accessible entrance on an accessible route
  2. Accessible public and common-use areas
  3. Usable doors
  4. Accessible routes into and through the dwelling unit
  5. Accessible light switches, electrical outlets, and environmental controls
  6. Reinforced bathroom walls, and
  7. Usable kitchens and bathrooms.

### **Americans with Disabilities Act (ADA)**

The Department of Justice (DOJ) issued regulations at 28 CFR parts 35 and 36 to implement the Americans with Disabilities Act (ADA). ADA prohibits discrimination on the basis of disability in areas of public accommodations. ADA does not apply to residential units.

**Compliance Standard:** Americans with Disabilities Act/Accessibility Guidelines (ADA/AG). For more information see [www.access-board.gov/adaag/html/adaag.htm](http://www.access-board.gov/adaag/html/adaag.htm).

### **Highlights of ADA requirements**

*In MFH projects ready for occupancy **on or before January 26, 1993:***

- When public areas are altered, they must be altered to ADA/AG standards. (Public areas are those areas used by individuals other than tenants and their guests. This includes offices used to pay bills or to inquire about service or employment, public restrooms, and buildings used for voting or public meetings.)

*In MFH projects ready for occupancy **after January 26, 1993:***

- Public areas must be designed and constructed to ADA/AG standards.

**Grid to show MFH borrower architectural accessibility requirements of Civil Rights laws and how they affect eligibility for Agency loans.**

	<b>Section 504</b>  Project ready for occupancy on or before 6-10-82	<b>Section 504</b>  Project ready for occupancy after 6-10-82	<b>Fair Housing Act</b>  Project ready for occupancy on or before 3-13-91	<b>Fair Housing Act</b>  Project ready for occupancy after 3-13-91	<b>ADA</b>  Project ready for occupancy on or before 1-26-93	<b>ADA</b>  Project ready for occupancy on or before 1-26-93
<b>New Construction</b>		Must meet UFAS requirements		Must meet UFAS and FHA/AG requirements		Must meet UFAS, FHA/AG and ADA/AG requirements
<b>Rehabilitation</b>	1. Encouraged to meet 5% requirement 2. Must meet common area requirement, if feasible 3. Must accommodate on request 4. Must have a self-evaluation 5. If required by self-evaluation, must have a transition plan	Must meet above requirements or be addressed during rehabilitation	Not applicable	Must meet above requirements or be addressed during rehabilitation	Must meet UFAS and ADA/AG requirements or be addressed during rehabilitation (If built after 3/13/91, FHA/AG requirements apply as well)	Must meet above requirements or be addressed during rehabilitation
<b>Equity</b>	Prior to the receipt of equity, must meet above requirements	Must meet above requirements or be addressed prior to receipt of equity	Not applicable	Not applicable (not eligible for equity at this time)	Not applicable	Not applicable (not eligible for equity at this time)
<b>Transfer without Rehabilitation</b>	Prior to transfer, must meet above requirements	Must meet above requirements prior to transfer	Not applicable	Must meet above requirements prior to transfer	Not applicable	Must meet above requirements prior to transfer
<b>Ongoing project operations – monitored by supervisory visits or compliance reviews</b>	Must meet above requirements	Must meet above requirements and must have a self evaluation and transition plan if found in non-compliance	Not applicable	Must meet above requirements	Not applicable	Must meet above requirements

## Self Evaluations and Transition Plans

On June 11, 1982, USDA issued 7 CFR 15b, which required all borrowers to conduct *self-evaluations* within 1 year of the USDA regulation. In the event that structural changes were necessary, recipients were required to develop *transition plans* that set forth the steps necessary to complete such changes.

### Who must conduct self-evaluations and develop transition plans?

- Borrowers of projects ready for occupancy on or before June 10, 1982.
- Borrowers of projects ready for occupancy after June 10, 1982, where the borrower has been found in non-compliance with Civil Rights law (as a remedial action).
- Borrowers who have had complaints filed against them, and the Agency determines it is necessary.
- Borrowers transferring ownership.
- Borrowers of projects receiving rehabilitation or equity loans, when the Agency determines it necessary.
- All state and local government borrower entities. (DOJ issued a regulation on July 26, 1991, which requires all State and local governments to conduct self-evaluations, unless they had already done so to meet the requirements of section 504.)
- Borrowers receiving loans after January 1, 2001, if a self-evaluation has not been previously conducted within the last 3 years.

### What standards do borrowers need to meet?

Regardless of when a project was ready for occupancy, all borrowers are required to have *policies and practices* that do not discriminate against persons with disabilities. The architectural *accessibility standards* borrowers must meet will depend on when the project was ready for occupancy and what modifications are planned. In addition, many State and local governments have their own accessibility standards that also must be met. **Rural Development does not have the authority to waive any of the accessibility requirements.** Waivers may only be granted by the Secretary of Agriculture. To date, no waivers have been granted.

### What are the self-evaluation and transition plan requirements?

In accordance with 7 CFR 15b the following is required:

#### Self-Evaluation

- (1) Evaluate, with the assistance of interested persons, including persons with disabilities or organizations representing disabled persons, its current policies and practices and the effects thereof;
- (2) Modify, after consultation with interested persons, including disabled persons or organizations representing disabled persons, any policies and practices that do not meet the requirements of this part;



(3) Take, after consultation with interested persons, including disabled persons or organizations representing disabled persons, appropriate remedial steps to eliminate the effects of any discrimination that resulted from adherence to these policies and practices; and

(4) To **maintain a record** of the self-evaluation for at least three years. The record must be made available for public inspection and be provided to the Agency upon request. The self-evaluation record must contain:

- (a) **a list of the interested persons consulted,**
- (b) **a description of areas examined and any problems identified, and,**
- (c) **a description of any modifications made and of any remedial steps taken.**

### **Transition Plans**

At a minimum, transition plans are required to:

- (1) Identify physical obstacles in the recipient's facilities that limit the accessibility of its program or activity to disabled persons;
- (2) Describe in detail the methods that would be used to make the facilities accessible;
- (3) Specify the schedule for taking the steps necessary to achieve full program accessibility and if the time period of the transition plan is longer than one year, identify steps that will be taken during each year of the transition period; and
- (4) Identify the person responsible for implementation of the plan.

**When structural changes are necessary, such changes shall be made within three years and as expeditiously as possible.**

### **Examples of policies and practices to be addressed include:**

- How will applicants and tenants be made aware that the owner will provide reasonable accommodations (unless doing so would cause an undue/administrative burden)?
- How will requests for reasonable accommodations be handled and who is authorized to approve or deny any such requests?
- Does the project have a Telecommunication Device for the Deaf (TDD) or an *equally effective communication system*? (Note: If the complex has section 8 assistance from HUD, the complex is required to have a TDD)
- If the project has a TDD, is the public made aware that there is a TDD? For example, is the TDD telephone number given each time the project's telephone number is given?

- If the project relies on a relay service as an *equally effective communication system* (rather than having a TDD), who is the relay service operated by? Is the relay service available 24 hours a day and without any added cost to the disabled person?
- Have procedures been established to accommodate hearing and sight impaired applicants and tenants. Examples of methods the borrower might use include readers, sign language interpreters, Braille, etc.
- Does management give priority for fully accessible units to persons who are in need of the special design features of an accessible unit? Is priority given first to those living in the complex and then to persons on the waiting list?
- Before accessible units are temporarily rented to people who do not need the special design features, have there been diligent marketing efforts to market the units as accessible units? Have those efforts been documented? Are lease clauses used? Do marketing efforts continue after renting the unit to someone who does not need the special design features?
- Is management's policy for verifying a person's disability limited to only that which is needed to establish eligibility and is verification required only after a tenant or applicant has asked that their disability be considered by management?
- Does management provide their employees with civil rights training?
- When marketing an elderly project, has there been an effort to reach all eligible people. Persons with disabilities (of any age) are every bit as eligible as persons who are 62 or older. Marketing efforts should be designed to reach both population groups.
- Does the recipient notify the public that they do not discriminate on the basis of disability? Do materials published by the borrower contain such a notice? Use of the Equal Housing Opportunity logo is one means of doing so (the logo is the house with the equal sign and the words Equal Housing Opportunity underneath the house).
- Does management have a policy that permits persons with disabilities to have service and/or companion animals?
- Does management give persons with disabilities the same choices other applicants are given? For example, both first and second floor apartments.

### **Monitoring compliance with the Self-Evaluation and Transition Plan**

The Agency monitors MFH borrower compliance with Civil Rights laws through the compliance review process. Servicing Office staff who have been trained and designated will conduct the compliance review using the general format of Form RD 400-8. To assure compliance with the self-evaluation and transition plan requirements of Civil Rights laws, during the compliance review Agency staff will:

1. Visually inspect the project to determine if there are physical barriers.
2. Review the management plan to determine project management's method of informing tenants and applicants regarding requests for reasonable accommodations.
  - Visit and interview tenants to determine if the borrower has provided information and made reasonable accommodations upon request by the tenant.
3. Visit and interview tenants in the fully accessible units to determine:
  - If the tenant has need of the accessibility features of the unit and is an eligible occupant.
  - When the tenant is an ineligible occupant of the unit, if the tenant and borrower have executed a lease attachment that requires the tenant to move if an individual needing the handicapped features applies for occupancy.
4. Review the lease agreement, application and other documentation used by the borrower to determine if policies and procedures represent barriers to occupancy.
5. Review the self-evaluation plan and transition plan and compare the physical inspection to determine if there are barriers present that were not addressed or scheduled to be removed.
6. Where transition plans are scheduled to remove barriers over more than a one-year period, review the transition plan and the most recently approved budget to assure that borrower budgeting and the projects financial condition is supportive of the transition plan as written. Transition plans should include the potential cost of removing identified barriers.

### **The Agency's response to findings of non-compliance**

#### **When the compliance review determines the following:**

- The borrower has not completed a self-evaluation when required.
- The borrower's self-evaluation does not adequately address required components.
- The borrower has not completed a transition plan when required by the self-evaluation.
- The borrower's transition plan does not adequately address required components.
- The borrower has failed to comply with their transition plan.
- The borrower is in-noncompliance with other Civil Rights law requirements.

#### **The Servicing Office takes the following actions:**

- Enter the appropriate finding under the Supervisory Activity, "Compliance Review" and provide descriptive comments on MFIS.
- Notify the borrower in writing and provide 30 days to come into compliance. The following language should be contained in your letter to the borrower regarding their con-compliance:

"Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued non-compliance may result in your ineligibility to receive further loan funds from the Agency. You failed to meet the following MFH physical standard(s) OR you are in non-compliance with the following: (Specify)"

If a borrower fails to either bring themselves into compliance within 30 days or submit an acceptable transition plan to bring themselves into compliance, the Servicing Office will notify the State Civil Rights Coordinator/Manager (SCRC/M). The State Director will forward the issue of non-compliance to the National Office Civil Rights Staff.

The National Office Civil Rights Staff will notify the State Director if further review and processing of the finding will either resolve the finding or require that it be forwarded to the USDA Civil Rights Staff or the Justice Department to resolve the non-compliance issue.

The SCRC/M will notify the State Office MFH Program Director and the Servicing Office of the disposition of the finding of non-compliance.